BUSINESS STUDIES

Textbook for Class XI

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FOREWORD

A meaningful school curriculum has to be responsive to society reflecting the needs and aspirations of it's learners. *The National Curriculum Framework for School Education—2000* (NCFSE) has elaborated the concerns and thrust areas which have to be taken into consideration while developing syllabi in different subject areas.

The higher secondary stage is a bridge between general education and specialised areas of learning. Students are in a position to exercise their choice of subjects keeping in view their needs, interests, capabilities and aptitudes. The course designed should enable them to pursue higher education at the university level or professional level. Business Studies is one of the specialised areas which initiates them into the world of business. The challenges of the world around us in the economy, the competition and changing requirements of customers have placed a number of demands on business. Information technology has broken previous barriers of time and space and created a global market for goods and services. Computerised systems are being used and the internet, electronic mail, electronic commerce are an integral part of business operations.

The liberalisation era has ushered in many economic and industrial reforms with respect to industrial licensing, foreign investment and technology and the public sector. As these reforms have had a tremendous impact on business many contemporary issues like disinvestment of public sector, export promotion measures, multinational corporations, foreign collaborations and e-commerce have been introduced in the textbook. Since business has a role to perform in society, environmental protection, human rights and business ethics, all form a part of the social responsibility of business, enabling students to appreciate the core of universal values of truth, righteous conduct, love, peace and non-violence.

The present textbook provides an analytical framework for understanding a business enterprise in the complex, dynamic environment of today. The content has been related to actual situations and examples from the business world. Content enrichment in the form of business news and abstracts of articles from business journals and magazines has been given as inset material. This will help students establish a correlation between the text

and the functioning of a business enterprise and the business news in print and electronic media.

I am grateful to the team of authors who have developed the manuscript and to all the members of the Review Workshop for their contributions.

The National Council of Educational Research and Training (NCERT) will welcome comments and suggestions for improvement of this textbook.

J.S. Rajput
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GANDHIJI'S TALISMAN

"I will give you a talisman. Whenever you are in doubt or when the self becomes too much with you, apply the following test :

Recall the face of the poorest and the weakest man whom you may have seen and ask yourself if the step you contemplate is going to be of any use to him. Will he gain anything by it ? Will it restore him to a control over his own life and destiny ? In other words, will it lead to Swaraj for the hungry and spiritually starving millions ?

Then you will find your doubts and your self melting away."

M K Gandhi

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CONSTITUTION OF INDIA

Chapter IVA

Fundamental Duties of Citizens

ARTICLE 51A

Fundamental Duties – It shall be the duty of every citizen of India —

(a) to abide by the Constitution and respect its ideals and institutions, the National Flag and the National Anthem;

(b) to cherish and follow the noble ideals which inspired our national struggle for freedom;

(c) to uphold and protect the sovereignty, unity and integrity of India;

(d) to defend the country and render national service when called upon to do so;

(e) To promote harmony and the spirit of common brotherhood amongst all the people of India transcending religious, linguistic and regional or sectional diversities; to renounce practices derogatory to the dignity of women;

(f) to value and preserve the rich heritage of our composite culture;

(g) to protect and improve the natural environment including forests, lakes, rivers, wild life and to have compassion for living creatures;

(h) to develop the scientific temper, humanism and the spirit of inquiry and reform;

(i) to safeguard public property and to abjure violence;

(j) to strive towards excellence in all spheres of individual and collective activity so that the nation constantly rises to higher levels of endeavour and achievement.

Part I

Foundations of Business

CHAPTER 1

Nature and Purpose of Business

LEARNING OBJECTIVES

After studying this chapter, you should be able to :

- state the different types of economic activities;
- explain the concept and characteristics of business;
- analyse the objectives of business;
- appreciate the role of profit in business;
- explain the evolution of business activities in India.

1.1 Introduction

All human beings, wherever they are, require different types of goods and services to satisfy their needs. One or two members of every family have to engage in some activities to earn money and provide for the needs of all members. Thus, people pursue different occupations to earn their livelihood and, depending on their income, have different standards of living. In modern times, a large variety of goods and services are available in the market. Also there is increasing demand for goods and services due to the desire of people to raise their standard of living. On the one hand, people engage in different activities so as to earn as much as possible and fulfill their increasing needs. On the other hand, the necessity of supplying goods and services has led to certain activities being undertaken by people to produce and sell what are needed by others. Thus, we find a large number of people earning their livelihood as agricultural labour, or working in offices, factories or mines. At the same time, there are people who produce and sell goods and services so as to earn income from these activities. Farmers may produce agricultural crops to be sold in the market. People set up factories to produce goods which may sold in retail shops. Trucks are manufactured and used to carry goods from one place to another. Supply of electric power, gas and water is arranged for use in factories as well as for domestic consumption. The purpose behind most of these activities of human beings is earning money by satisfying the increasing demand for goods and services.

In this chapter, we shall first discuss the nature of economic activities, and then explain the concept and definition of business, its characteristics, objectives of business, the nature and causes of business risks, and role of profit in business. We shall also describe briefly, the evolution of business activities in India.

1.2 Economic Activities

In every society people are found to undertake various activities to satisfy their physical or material needs like food, clothing, and other articles of use. These activities may be connected with production or distribution of goods such as cultivating land, running a factory or working in the factory, driving a truck to transport goods, etc. These are undertaken by people to earn income to meet their needs. People may also be working in offices where they offer their services for a salary. Thus, economic activities are based on economic considerations for transfer or exchange of goods and services. The purpose of economic activities should be expectation of money income which is used for further creation of wealth or assets.

Sometimes, people also undertake or engage in certain activities for deriving psychological satisfaction, as a social duty, or in discharge of a moral obligation. These are non-economic activities. People may take part in

games and sports, engage in recreational activities, pursue gardening as a hobby, find time for social service or volunteer to work for a humanitarian cause. Such activities are non-economic activities as their purpose is not to earn money or to satisfy material needs.

Economic activities may be pursued by individuals on a small scale, or by groups of people on a large scale. Thus, a hawker selling toys for children, and person repairing bicycles and scooters on the roadside, or a retail shopkeeper selling stationery are examples or individuals pursuing economic activities on a small scale. On the other hand, factories set up for mass production of goods, or crops raised for sale in big agricultural farms are large scale economic activities in which groups of people are engaged. When a person individually or as member of any group is regularly engaged in any economic activity, it is said to be her/his occupation.

1.3 Types of Economic Activities

Broadly speaking, the occupation of people or economic activities may be divided into three categories: (i) Business; (ii) Profession; and (iii) Employment.

Business refers to those economic activities which are connected with the production or purchase and sale of goods or supply of services with the main object of earning profit. People engaged in business earn income in the form of profit.

Profession includes those activities which require special knowledge and skill to be applied by individuals in their occupation. Such activities are generally, subject to guidelines or codes of conduct laid down by professional bodies. Those engaged in professions are known as professionals. For example, doctors are professionals who are in the Medical profession and are subject to the regulations of the Medical Council of India, the concerned professional body. Lawyers are engaged in the Legal profession governed by the Bar Council of India. Accountants belong to the Accounting profession and are subject to the regulations of the Institute of Chartered Accountants of India.

Employment refers to the occupation in which people work for others regularly and get remunerated in return. Those who are employed by others are known as *employees*. Thus, people who work in factories and receive wages and salaries are in the employment of factory owners and are employees of the factory. Similarly, people who work in the offices of banks, insurance companies or government departments are in employment, may be as managers, assistants, clerks, peons or security guards.

1.4 Concept and Characteristics of Business

1.4.1 Concept of Business

The term *business* is derived from the word *busy*. Thus, business means being busy. However, in a specific

sense, business refers to any occupation in which people regularly engage in activities with a view to earning profit. The activity may consist of production or purchase of goods for sale, or exchange of goods or supply of services to satisfy the needs of other people. Since the main objective of business is to earn income or profit through business dealings, it is an economic activity. Business may thus, be defined as *any economic activity on a continuous basis* which involves production or purchase of goods for sale, transfer or exchange of goods, or supply of services, at a profit.

In modern times, as we all know, business does not merely deal with goods and services and cannot be defined or explained in terms of profit only. Business by dealing in goods and services does not necessarily become a business unless it has a customer. A business therefore, needs to be defined in terms of purpose of the business.

Business is an integral part of society, produces goods and services for society and offers them for sale to people in that society. Unless the goods are satisfactory and preferred by people, they will not buy the goods. Therefore, the business first has to create a customer for itself from the society in which it exists. Economic forces also play an important role in creating markets but it is basically the business which has to identify needs and satisfy customers. The customer determines what a business is. The customer by paying for a good or service provides revenue and profit, thus converting economic resources into wealth and things into goods. The business may produce what it wants but unless the customer buys it and is satisfied it will not contribute to it's future success. No business can exist without a customer.

We have stated that business in terms of creating a customer is the only purpose of business. To fulfill this purpose, business enterprises should concentrate on two basic functions — marketing and innovation.

Marketing is a specialised activity which encompasses the entire business. The business gears itself to marketing by producing what the market needs and planning all activities accordingly. These activities would include identifying needs, planning the product or service and then ultimately selling it at a price which satisfies the customer. The whole business is seen from the customer's point of view and marketing is made the concern and responsibility of all the managers in the business organisation.

The second function which a business must perform is to innovate. Unless the business aims at producing something new or improving the existing product it cannot expand it's market. Business is an instrument of growth and change and change cannot be ushered in unless business innovates. Innovation may lead to technological upgradation of production processes. It may take the form of lower price, new and better products (at a higher price), a new

convenience or creation of a new want. Technology helps business to innovate in design, in product and in marketing techniques. Business has to invest in technology which will ultimately help in meeting competition. But innovation is not restricted to engineering or research but extends to all parts of business. Innovation may be in distribution methods, advertising and selling techniques or new instruments of finance. Business therefore, is not restricted to only dealing with goods and services for a profit. There are other more important aspects to business, viz., creating a customer, marketing and innovation.

1.4.2 Characteristics of Business

Business activities are distinct from other economic activities in certain respects which will be clear from the following main characteristics of business :

(i) Sale or exchange of goods and services for the satisfaction of human needs : Directly or indirectly business involves transfer or exchange of goods and services for value. If goods are produced or purchased to be consumed by the producer or buyer, it cannot be called a business activity. Or, if goods are purchased by one to be presented as gift to someone else, it is not business. Cooking food at home for the family is not business, but cooking food and selling it to others in a restaurant is business. Thus, one essential characteristic of business is that there should be sale or exchange of goods or services.

(ii) Dealings in goods and services on a regular basis : Another distinct feature of business is that it involves dealings in goods or services on a regular basis. Goods may consist of consumable items of daily use or capital goods like machinery used in factories. Services may include facilities offered to consumers in the form of transportation, banking, storage space, supply of electricity, etc. Whatever their nature, dealing in goods and services must be on a regular basis to be called business activity. One single transaction of sale or purchase does not constitute business. Thus, for example, if a person sells her/his domestic radio set even at a profit, it will not be considered as a business activity. But if she/he sells radio sets regularly either through a shop or from her/his residence, it will be regarded as a business activity.

(iii) Profit earning : The main purpose of business is that of earning income by way of profit. No business can survive for long without earning profit. That is why businessmen make all possible efforts to earn satisfactory profits by increasing the volume of sales or reducing costs.

(iv) Uncertainty of return and business risk : Every business requires some amount of money (capital) to be invested to run the activities. Profits are expected to be earned in proportion to the amount of investment in the business. But it is not certain that adequate profit will be earned. There is always a possibility of losses being incurred in spite of best efforts. This is

Risky Business

Risk is a term rarely used in Indian business and analytical writing, and common understanding reflects that neglect. In simple terms, risk involves events not turning out in line with expectations. Statistically, it is measured by volatility metrics, like standard deviation.

For a layman, it implies that if sales and profits turn out less than expected, you'll lose money. As the proprietor of a unlimited liability business, you will immediately notice the hole in your bank account. An investor in a listed company is hit by a fall in share price as market revises its view of the company's business.

Share prices are inversely proportional to risk perception. Even employees and other stakeholders — like franchises — can be hurt by a wrong understanding of risk. A company facing an unforeseen sharp slowdown will lay off employees. The franchises will suddenly see their economics looking very different.

Source : The Economic Times

because market conditions may change leading to a decline in production or sales and reduced profits. Also there may be unexpected situations beyond the control of businessmen resulting in losses. These possibilities are known as risks of business. The risks are related with certain factors like changes in consumer tastes and fashions, changes in methods of production, strike or lockout in work place, increased competition in the market, fire, theft, accidents, natural calamities, etc. No business can altogether do away with risks. Hence, uncertainty of return on investment may be regarded as a significant characteristic of business implying risks.

1.5 Objectives of Business

The objectives of a business should be well defined and must leave no scope for ambiguity. Since a business has to balance a number of needs and goals it requires multiple objectives. It cannot follow only one objective and expect to achieve excellence. Objectives have to be very specific and are needed in every area and sphere of business. Foe example, sales figures have to be set, the amount of capital to be raised has to be estimated and the target number of units to be produced should be defined. The objectives define what the business is going to do in concrete terms and enable the business to analyse their own experience and as a result improve their performance.

All objectives are equally important at some time or the other depending on a number of internal and external factors. How much time, effort and energy should go in pursuing a particular objective is to be decided by the business itself. This is where business acumen and judgement play an important role in balancing of objectives.

Business objectives may be classified broadly into economic objectives and social objectives.

1.5.1 Economic Objectives

Since business is a type of economic activity, it's main objectives are economic objectives which include the following :

(i) Earning profit;
(ii) Market standing;
(iii) Innovation; and
(iv) Best possible use of scarce resources.

(i) Earning profit : Business activities are undertaken primarily to earn profit, which is the excess of income over expenses. A business cannot survive without making profits. Indeed, profit is a measure of the success in business. Profits not only help businessmen to earn their living, it also helps to expand their business activities. Growth of business largely depends on its ability to earn profits and reinvest a part of it for expansion. Besides, it is on the basis of its profit earning capacity built upon efficiency of performance that a business can gain in prestige and have a *good image*. Thereby it can attract competent employees and secure customer loyalty. Thus, earning profit is an economic objective which governs all business operations.

(ii) Market standing : Business activity can be sustained only if it has any standing in the market. It is not enough for the business to fulfil the purpose of creating a customer. The business has to be more specific and analyse the market and find out where it stands. The market consists of customers as well as competitors. To measure market standing two things have to be taken into consideration — market potential and competition. The business has to determine in quantifiable terms the present and prospective customers and what share of the market it has been able to capture. Accordingly an objective has to be set for sales figures, the size of the market and the share in the market.

The business also has to see itself in the light of competition. Sales may be increasing every year but competing products may have a larger share of the market and may have new and improved features. Therefore, the strength of a competitor must never be underestimated. The objective, of a business must therefore be to establish a place in the market and protect itself from competition.

(iii) Innovation : To innovate means to explore and discover ways and means of making products more useful. It also includes improving methods of production, exploring new markets, and use of better methods of distribution. Making lap-top computers besides desk computers is an example of product innovation. Using power loom instead of handloom for weaving cloth is an example of process innovation. Manufacturers setting up retail shops of their own instead selling their products through wholesalers or dealers may be regarded as an example of innovation of distribution method. In a competitive market, every business must be on the look out for introducing new products or making the existing products more useful. It may be possible to do so by creative thinking

unforeseen events may lead to losses. For example, the cost of agricultural raw material may go up due to failure of crops. As a result, cost of production may increase and, in turn, reduce profits. None of these events is easily predictable, nor can they be fully controlled by a business unit. That is why business activities become risky.

The more important causes of business risks are the following :

(i) Uncertainties relating to demand for goods, competition, prices, collection of dues from customers, change of technology or method of production.

(ii) Unforeseen losses arising out of fire, theft, or natural calamities like flood or earthquake.

(iii) Unexpected events like stoppage of work due to power failure or workers being on strike, loss or damage to goods in transit.

(iv) Financial problems like rise in interest rate for borrowing, levy of higher taxes, etc.

Wealth is Created During Periods of Uncertainty

Everything bad that has happened during the past year — the dotcom implosion, the recession, the terror, the war — destroyed the illusion that we operate in a world that is continuously prosperous. As it turns out, our world is nothing like that. Our lives are routinely disrupted, our work dislocated. This is how Professor Yoram *Jerry* Wind of University of Pennsylvania's Wharton School sees it.

The only risk that leads to profit is unique uncertainty. Making money depends on identifying opportunities in a turbulent market place. Wind proposes three essential characteristics of organisations that flourish in times of turmoil.

- **Disciplined opportunities** : There are huge opportunities to buy cheap assets. You can buy technology or talent for less now and build assets in future. But you need to be careful and disciplined about it. You might get a failing technology for half its book value or an asset that adds to your company's strategic strengths.
- **Continuous learning and unlearning** : The fundamental challenge is to ask, why do we do it. The usual answer is because they've worked in the past. But they may not work in future. In a fast changing market place, the assumptions driving your current vision and strategy won't stay the same for long. We must realise we have to unlearn the things that might be a constraint. Balancing the two, learning and unlearning must be a dynamic process.
- **Adaptive experimentation** : In a turbulent environment, no strategy is optimal, so you have to create an environment to continuous experimentation — a way to design projects that allows you to learn, adapt and change. Radical experimentation forces everyone to innovate. And it is a competitive weapon. If you are experimenting a lot, other companies can't figure out what you're doing. Experiment, measure, modify and react — it's a powerful way to learning.

Source : The Economic Times

To a large extent, business risks arising out of certain factors are unavoidable. But losses arising out of certain risks can be recovered if the risks are insured for which a small amount has to be paid as premium for insurance. When goods are transported by rail, road or sea transport, the risk of loss or damage in transit can be insured. Similarly, machinery, goods in stock, etc. can be insured against risks of loss due to fire or theft. Besides, certain losses arising out of risk can also be shared. Manufacturers and wholesalers may have an agreement to share any loss which may be caused by falling prices. However, the risk remains though the loss is shared.

1.7 Role of Profit in Business

Although earning profit cannot be the only objective of business, its importance cannot be ignored. It may be regarded as an essential objective of business for various reasons.

(i) As a source of income for businessmen, profits provide the means of livelihood for them. No one is expected to undertake business activities without earning profit to satisfy her/his needs.

(ii) Profits earned can also be a source of finance for expansion of business activities. When profits are large, a reasonable part of it can always be reinvested for expansion or diversification of production, or to create new facilities for more efficient operation. Retention of profits as an internal source of funds is a more dependable source of financing than external sources like banks, financial institutions, or individual investors.

(iii) Profits indicate whether a business is being managed efficiently or not. Thus, profit is invariably regarded as an indicator of the quality of performance of those who manage the business. The success of a business can be judged by its ability to earn profits.

(iv) Besides, it is because of profits that taking risk becomes worthwhile in business. Indeed, profits are also regarded as a reward for risk bearing. It is in the hope of earning sufficient profits that a businessman invests money in business in spite of the risks and uncertainties and the possibility of incurring losses.

(v) Finally, with increasing profits over time a business earns reputation. It is able to raise loans and obtain credit more easily. It is in a better position to offer higher wages and salaries so as to attract trained and experienced employees. Existing employees can also be provided

Role of Profits

- Means of livelihood for businessmen.
- Source of funds for business growth.
- Index of performance.
- Reward for risk taking.
- Better employee remuneration and amenities.

with better working conditions and more amenities if the business is profitable.

1.8 Evolution of Business Activities in India

Business activities as we find around us today evolved over a long period of time since the dawn of civilisation. Let us see how.

(i) Family centred village communities : In the early days of civilisation, human life in India was family centred and village communities were by and large self-sufficient. They produced what they needed. Cultivation of land, grazing of domestic animals, fishing and hunting were the main occupation of people. There were artisans like carpenters and blacksmiths who provided their services to farmers and their families. Weaving was a traditional skill which took care of the village needs of clothing. Exchange of goods for goods (barter) was required to satisfy the

Historical Events That Shaped Business

1025 Cholas like today, it was the Southerners powering economic growth then. Rajendra Chola's (1016-44) navy conquered Maldives and defeated Sri Vijaya. Chola and Company gained access to the east Asian markets. And like Coke, the Cholas too had their own brand of cultural colonisation.

1498 Vasco de Gama's boss, the King, wanted the global economy expert to find new markets. Indians welcomed the sailors, selling spice to them at double the price. Thus, began India's contact with the world's fastest growing economy. De Gama went home to sell the spices for a 3000 per cent margin and soon after, the first Portuguese settlement had started at Kozhikode.

1540 Sher Shah Suri had figured out that a long stretch of road would help him both militarily and commercially. The Grand Trunk Road stretched from the Indus River in the west to Sonargoan (Bangladesh). Trade boomed on this freeway with qasbas (market places) opening up. This 1500-mile road is still the arterial link that connects six Indian states.

1556 It was Akbar who introduced silver rupee of high purity, which became the standard coin here and abroad. This marked the start of the monetisation of the economy. He set up a system of land records and revenues. Since the bureaucracy was also well paid, Akbar's rule ushered in the first spate of conspicuous consumption.

1599 East India Company : A bunch of seafarers formed Merchant Adventurers, which soon renamed itself the East India Company. The Queen granted it exclusive privileges to trade in the east and the East India Company headed towards India. Soon, it started trading here and then put together a bunch of expatriates who would kick off political domination. The rest, as they say, is history.

Source : Business World

difference in needs of people. But the difficulties of barter as a mode of exchange were increasingly felt. It required double coincidence of wants and possession of surplus which created problems. Besides there was no common measure of value. It was Thus, difficult to fix the exchange value of one commodity for another. Moreover, the absence of any medium of exchange required physical transfer of goods everytime exchange took place.

This involved trouble and inconvenience. For a certain period, these problems were solved by using some commonly acceptable commodity as a medium of exchange, like shells, conches, and even salt or specified quantities of foodgrain. This was an improvement over the exchange process.

(ii) Growth of bazaars : Since people with surplus goods desired that others in need of those goods should be easily identified, selected places were decided for them to come together. Thus, in course of time, bazaars and 'mandis' developed as market places in villages. In this process, some people emerged in these weekly bazaars as traders or merchants to help others in exchanging goods conveniently.

Historical Events That Shaped Business

1609 First Factory: The MNCs start arriving with the Dutch and the English following in Vasco de Gama's wake. A British factory set up shop in Surat in 1612. Trade booms, and the Industrial Revolution gets underway in British and Indian business embraces the opportunity. Corporate India changes forever.

1757 Battle of Plassey: The first leveraged buyout of its kind, the East India Company's army and its council is to receive £ 2.75 lakh each, Calcutta's Hindus £ 2.2 lakh Europeans £ 5.50 lakh and Armenians £ 77000 if Lt-Colonel Robert Cilve defeats Siraj-ud-daula. Superior tactics ensured that Clive won the day. For the East India Company, this removed all barriers to consolidation of its powers and India would remain a subsidiary for another century.

1834 Dwarkanath Tagore forms Carr Tagore and Company: Between 1834 and 1847, seventeen companies come up in Calcutta, mostly set up by people hailing from non-business communities. New economic opportunities shake up for the first time the equilibrium that has always existed between social class and occupational choice. It is democratisation, round one.

1835 First Rupee: The East India Company introduces the rupee and brings about unification of currency. Before this, there are some 1000 currencies in circulation. Since these many currencies devalue frequently, there are no standard rates of exchange and moneylenders charge arbitrary rates of interest. This hampers trade and commerce. But the introduction of the East Indian rupee changes it all.

Source : Business World

Landmarks in Indian Business

1947 Independence, Partition, India wins freedom, but at a huge price. The big jute mills are lost to East Pakistan, the fertile wheat and cotton fields of West Punjab are forfeited and the merchant city of Karachi is gone forever. Moreover, 22 of the big Muslim business families (the Boras etc.) migrate to Pakistan, taking a large part of their liquid capital. A lot of big British firms decide to quit India.

1948 IFCI to provide avenues for raising funds to industry, the Centre sets up the Industrial Finance Corporation of India. It's the beginning of state intervention in the creation of wealth. The Industrial Credit and Investment Corporation of India is formed in 1955 to underwrite new issues. Over the years, other development finance institutes are established to take up the slack in bank financing of long-term industrial projects.

1961 Prakash Tandon becomes the first Indian Chairman of Hindustan Lever. Tandon's elevation indicates the growing importance of Indian mangers. Ajit Haksar takes charge at ITC and the Indian management cadre doesn't look back. Today, MNCs like McKinsey and Company are headed by Indians.

1965-? India's scientific and technological manpower heads for the land of opportunity where universities seduce India's best and the brightest with tip-dollar scholarships and a better life. After the economic drain under British rule, this is the biggest example of one-way capital flow out of the country. Decades later, people like Vinod Khosla and Kanwal Rekhi, create a dominant presence in Sillicon Valley and establish Indian supremacy in the knowledge of economy.

Source : Business World

development of towns and industrial cities and trade centres contributed to the growth of trade and related activities including banking, insurance and warehousing, along with ports, harbours and dock facilities along the eastern and western coasts of India. Simultaneously, there has been expansion of economic activities in different forms of organisation, sole proprietorship, partnership, coopera-tive societies, and joint Hindu family business. But in terms of the amount of capital invested, the company form of organisation has developed as the most important segment of business activities. We thus, find now small retail shops in cities, towns and rural areas as well as large stores and super bazaars in cities, besides small workshops and medium scale factories along with large manufacturing plants like the integrated steel plants, heavy engineering, heavy electricals and heavy chemical industries.

(viii) Growth of public and private enterprises after independence : Since independence, the nature and scope of business enlarged in many ways. A number of

large scale industries were developed in the public sector by the central and state governments. These included integrated steel plants, heavy engineering industries, exploration of oil and natural gas, and refining of fuel oil, capital goods industries — machines tools, aluminum, cement, locomotives, aircraft, shipping, telecommunication equipments — besides dominant undertakings in the banking, insurance, and financial sectors. Private enterprises have also developed on a large scale in trade, industry and service sectors covering a wide range of consumer goods industries — cotton and synthetic fabrics, soap, detergents, toiletry, skin-care products, processed food items, ready made garments, drugs and medicines as well as durable consumer goods industries like automobiles,

Licensing and Liberalisation Era

1965-73 Licensing era: Indira Gandhi imprisons corporate India. The aim — regulate private sector investments and give them a socialist orientation. The attempt to direct investments to desirable industries binds businessmen in realms of red tape. The MRTPC (1969) and draconian laws like Fera (1973) tackled the symptoms, not the problem.

1977 First Reliance issue three days after Christmas the cult of retail shareholding is born. The prospectus shows how its net fixed assets grew by 49 times in 10 years and gross profits 28 times in nine years etc. the issue opens at Rs 12.25 per share. In the process, a legend is born.

1986 Sam Pitroda PCOs calling all Indians, everywhere, black-on-yellow PCOs connect rural areas to the rest of the country. The booths boost employment. As Rajiv Gandhi's chief technology advisor, Pitroda masterminds the transition to digital switching systems. Pitroda's telecom revolution is also an indication of how things could change.

1991-99 Liberalisation and Nasdaq listings put an end to the country's control regime and integrates the country with the rest of the global economy. The changeover creates a huge discontinuity with the past which coupled with the evolution of the knowledge economy, kicks off the process of democratisation of capital. By end of the decade, the transformation is almost complete in 1999; the Bangalore-head quartered Infosys Technologies becomes the first Indian company to be listed on Nasdaq – the world's largest stock exchange for tech companies. Ranbaxy sells its developed-at-home drug delivery system for a king's ransom, an internet entrepreneur in India sells his four-year-old company for a stunning sum of Rs 499 Crore.

Source : Business World

scooters, bikes, TV, washing machines, refrigerators, air-conditioners, electrical and electronic gadgets for domestic use. In the service industries, private sector participation has increased fast in recent times, particularly in road transport, telecommunication, energy supply, banking and insurance as also financial services.

Besides, Indian enterprises, foreign investment in industries — automobiles, white goods, garments, computer engineering and fast food have widened the range of products manufactured and their distribution outlets. Multinational corporations on their own and through joint ventures with Indian corporates have made business activities more diversified and competitive.

Along with the growth in volume of domestic trade, India's exports and imports have also registered impressive growth in recent years due to the liberal import-export policy of the government. The value of exports have increased at an average rate of 10 per cent per annum and imports at 13.2 per cent per annum during the nineties. However, the share of India in world trade is still very small.

SUMMARY

Economic activities: In every society people are found to undertake various activities to satisfy their physical or material needs like food, clothing, and other articles of use. These are known as *economic activities*. Sometimes people also undertake or engage in certain activities for deriving psychological satisfaction, as a social duty, or in discharging of a moral obligation. These are *non-economic activities*. Economic activities may be pursued by individuals on a small scale, or by groups of people on a large scale. When a person individually or as member of any group is regularly engaged in any economic activity, it is said to be his or her occupation.

Types of economic activities: Business refers to those economic activities which are connected with the production or purchase and sale of goods or supply of services with the main object of earning profit.

Profession includes those activities which require special knowledge and skill to be applied by individuals in their occupation.

Employment refers to the occupation in which people work for others regularly and get remunerated in return.

Concept of business: The term *business* is derived from the word *busy*. Business may thus, be defined as any economic activity on a continuous basis which involves production or purchase of goods for sale, transfer or exchange of goods, or supply of services, at a profit.

Characteristics of business: Sale or exchange of goods and services for the satisfaction of human needs; dealings in goods and services on a regular basis; profit earning; uncertainty of return and business risk.

Objectives of business: These may be classified broadly into economic objectives and social objectives.

(i) *Economic objectives:* Earning profit; market standing; innovation; and best possible use of scarce resources.

(ii) *Social objectives:* Besides pursuing economic objectives, it is necessary that business, in its own interest, should also pursue certain objectives conforming to the expectations of society. These are supply of desired quality of products; avoidance of anti-social or unfair trade practices; generation of employment; welfare of employees; and community service.

Business risks: Business risks refer to the probability of inadequate profits or even losses due to uncertainties or unexpected events, which are beyond control. None of these events is easily predictable, nor can they be fully controlled by a business unit. That is why business activities become risky. The more important causes of business risks are — uncertainties relating to demand, unforeseen losses, unexpected events, financial problems. To a large extent, business risks arising out of certain factors are unavoidable. But losses arising out of certain risks can be recovered if the risks are insured for which a small amount has to be paid as premium for insurance.

Role of profit in business: It may be regarded as an essential objective of business for various reasons. As a source of income for businessmen, profits earned can also be a source of finance for expansion of business activities. Profits indicate whether a business is being managed efficiently or not. Besides, it is because of profits that taking risk becomes worthwhile in business. Finally, with increasing profits over time a business earns reputation.

Evolution of business activities in India: Business activities as we find around us today evolved over a long period of time since the dawn of civilisation. Let us see how. *Family centred village communities,* in the early days of civilisation, human life in India was family centred and village communities were by and large self-sufficient. Exchange of goods for goods (barter) was required to satisfy the difference in needs of people.

Growth of bazaars: Since people with surplus goods desired that others in need of those goods should be easily identified, selected places were decided for them to come together.

Middle ages, town economy and emergence of money: During the middle ages (5^{th} to 15^{th} century AD) the towns which were the seat of a court or capital of a province started attracting people from the villages. Metallic currency was introduced at this time by Kings under the Royal seal which circulated as money.

Trading across the seas and oceans: The discovery of sea routes by Columbus

and Vasco de Gama led to an extension of business activities between far off countries. During the 16th and 17th centuries, trading companies were formed in European countries to avail of the greater scope of trade across the seas and oceans.

Machine age/industrial revolution: Between 1760 and 1820, the methods of producing goods started changing fundamentally in the technical sense first in England and then in other European countries. The period which followed is known as the *Machine Age* and often referred to as the period of *Industrial Revolution.*

Decline of cottage industries and handicrafts: Indian cottage industries and handicrafts were adversely affected.

Growth of modern industries, transport, banking and insurance: The British rule having been firmly established in India by the middle of the 19th century, industry and trade as well as railway transport on modern lines started growing in India. The enterprising spirit and pioneering efforts of Indian business leaders laid the foundation of large scale manufacture of iron and steel, cement, chemical, auto mobile, ship-building, light and heavy engineering, minerals and metal products. There has been expansion of economic activities in different forms of organisation, sole proprietorship, partnership, cooperative societies, and joint Hindu family business. But in terms of the amount of capital invested, the company form of organisation has developed as the most important segment of business activities.

Growth of public and private enterprises after independence: A number of large scale industries were developed in the public sector by the central and state governments. Private enterprises have also developed on a large scale in trade, industry and service sectors covering a wide range of consumer goods industries — cotton and synthetic fabrics, soap, detergents, toiletry, skin-care products, processed food items, ready made garments, drugs and medicines as well as durable consumer goods industries. In the service industries, private sector participation has increased fast in recent times particularly in road transport, telecommunication, energy supply, banking and insurance as also financial services. Multinational corporations on their own and through joint ventures with Indian corporates have made business activities more diversified and competitive. Along with the growth in volume of domestic trade, India's exports and imports have also registered impressive growth in recent years due to the liberal import-export policy of the government.

EXERCISES

Short Answer Type Questions

1. State the different types of economic activities.

2. Why is business considered an economic activity?
3. Explain the concept of business.
4. Why should a business pursue social objectives?
5. What is the role of profit in business?
6. What was the impact of the emergence of money on trade and business?
7. How has the discovery of sea routes facilitated trade?

Long Answer Type Questions

1. Explain the characteristics of business.
2. First earning profits the only objective of business? Discuss.
3. Explain the concept of business risk and its causes.
4. How did the growth of transport and banking contribute to the growth of modern industries?
5. Discuss the role of the public and private enterprises in business after independence.

Project Work

1. Find out from local business units the various objectives they pursue. Do they actually pursue any social objectives? Try and make them aware of other objectives.
2. Study any business unit (trading or manufacturing) and find out the kind of risks they face in business. How do they overcome these risks?

CHAPTER 2

Social Responsibility of Business and Business Ethics

LEARNING OBJECTIVES

After studying this chapter, you should be able to :

- explain the concept of social responsibility;
- examine the case for and against social responsibility;
- identify the responsibility towards different interest groups;
- appreciate the role of business in promoting the cause of human rights;
- analyse the causes of environmental pollution and business responsibility;
- define the concept of business ethics.

2.1 Introduction

In the previous chapter, we have discussed the nature and objectives of business and explained that economic objectives could be better achieved by serving the society in a meaningful manner. Business is one of the critical organs of society and it draws its strength from that. In the long run a successful business can be built on the foundations of a happy community around and a motivated and satisfied workforce. For example, in the1970s, the Articles of Association of the major Tata companies were formally amended to read that the *company shall be mindful of its social and moral responsibilities to the consumers, employees, shareholders, society and the community*. Looking into the growing importance of social responsibilities of business, in this chapter we shall discuss the concept and case for responsibility of business towards different interest groups, human rights, environment protection and role of ethics in the management of business.

2.2 Concept of Social Responsibility

There are many definitions of social responsibility. But, in general, the concept means many things such as: (i) a private enterprise has responsibilities towards society that goes beyond the production of goods and services at a profit; (ii) a corporation has a broader constituency to serve than that of stockholders alone; (iii) corporations relate to society through more than the market place alone; and (iv) they serve a wider range of human values than the traditional economic values that dominate the market place. Corporate social responsibility means that corporations are more than simply economic institutions, and Thus, they have a responsibility to help society in solving some of its most pressing social problems (many of which were caused in part by corporations) by devoting even some of their resources.

The concept of social responsibility received increasing attention during 1960s because of the need for corporations to respond to the changing social environment of business. This change was often described as a change in terms of the understanding between business and society that reflected changing expectations regarding the social performance of business. The old understanding between business and society was based on the view that economic growth was the source of all progress, social as well as economic. The engine providing this economic growth was considered to be the drive for profits by competitive private enterprise. The basic mission of business was Thus, to produce goods and services at a profit, and in doing this business was making its maximum contribution to society, and in fact, being socially responsible.

The new understanding between business and society is based on the

view that the singleminded pursuit of economic growth produce some detrimental side effects that impose social costs on certain segments of society or on society as a whole. The pursuit of economic growth, it is believed, does not necessarily lead automatically to social progress. In many cases it has actually led to a deteriorating physical environment, an unsafe workplace, needless exposure to toxic substances on the part of the workers and consumers, discrimination against certain groups in society, urban decay, and other social problems. This new understanding between business and society involved the reduction of these social costs of business by impressing upon business the idea that it has an obligation to work for social as well as economic betterment. This new understanding does not invalidate the old one but it simply adds new terms or additional clauses to that understanding. The new understanding includes a responsibility for both economic and social impacts.

The concept of social responsibility is fundamentally an ethical concept. It involves changing notions of human welfare and emphasises a concern about the social dimensions of business activity that have a direct connection with quality of life in society. The concept provides a way for business to concern itself with these social dimensions and pay some attention to its social impacts. The word responsibility implies that business organisations have some kind of obligation toward the society in which they function to deal with social problems and contribute more

Definitions of Social Responsibility

Social responsibility refers to the obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action, which are desirable in terms of the objectives and values of our society. **Howard R. Bowen**

Social responsibility is to create maximum shareholder value working under the circumstances where it is fair to all its stakeholders, workers, consumers, the community, government, and the environment. **Narayana Murthy**

The idea of social responsibilities supposes that the corporation has not only economic and legal obligations but also certain responsibilities to society, which extend beyond these obligations. **Joseph W. McGuire**

Corporate social responsibility relates primarily to achieving outcomes from organisational decisions concerning specific issues or problems, which (by some normative standard) have beneficial rather than adverse effects upon pertinent corporate stakeholders. The normative correctness of the products of corporate action have been the main focus of corporate social responsibility. **Edwin M. Epstein**

than just economic goods and services.

2.3 Case for Social Responsibility

In spite of the dominant role of profit in the running of business, today, businessmen are more conscious of their social responsibilities on account of the following factors:

(i) Changed public expectations from business : One of the most potent arguments for social responsibility is that public expectation from business has changed. It is reasoned that the institution of business exists only because it satisfies valuable needs of society. Society gave business its charter to exist, and that charter can be amended or revoked at any time that business fails to live up to society's expectations. Therefore, if business wishes to remain viable in the long run, it must respond to society's needs and give society what it wants.

(ii) Better environment for business : The second argument favouring social responsibility is that it creates a better environment for business, since a better society may produce environmental conditions more favourable for business operation. The firm, which is the most responsive to improve people's quality of life, will as a result have a better community in which to conduct its business. Recruitment of labour will be easier, and labour will be of a better quality. The turnover and absenteeism will be reduced. As a result of social improvements, crime will decrease, with the consequence that lesser amount would be spent to protect property, and less taxes have to be paid to support police forces.

(iii) Public image : Another argument is that social responsibility improves the public image of business. Each individual firm seeks an enhanced public image so that it may gain more customers, better employees, and other benefits. This type of expectation is traditional with business; therefore, it is easy to extend this public image concept to the accomplishment of various types of social goals.

(iv) Avoidance of government regulation : A related argument is that business should engage in socially responsible behaviour to avoid regulation by government. Regulation is costly to business and restricts its flexibility of decision-making. From the businessman's point of view, it is desirable to retain freedom in decision-making so that she/he can maintain the initiative in meeting market and social forces. This view is also consistent with political philosophy, which wishes to keep power as decentralised as possible in our democratic system.

(v) Problems can become profits : It may also be argued that if the innovative ability of business can be turned to meet social problems, many problems could be handled profitably according to traditional business concepts. It is recognised

that not all problems can be handled in this way, but the fact that some can be so handled should encourage business to become more active in social areas. For example, phosphate strip mining companies in Florida have found that after mining they can convert the land to home sites on lakes, resulting in better land than it was originally — all with a profit. Chemical companies have found that they can reclaim some wastes at a profit, and other firms are examining similar profit possibilities.

(vi) Balance of responsibility with power : Another reason underlying the notion of social responsibility relates to the balancing of power and responsibility. Because business enjoys considerable social power — in that its activities and decisions affect the environment, consumers, employees, community conditions, and many other areas of society — it has a corresponding responsibility in relation to society. Responsibility is a necessary reciprocal of power, and any imbalance opens the door to irresponsible behaviour that may negatively affect the welfare of society. Responsibility, thus, arises from power, and if business insists on avoiding its social responsibilities, then some of its power may be gradually taken away by other societal groups or institutions such as government, which will then shape business behaviour through legislation and regulation

(vii) Business has useful resources : Further, one may argue that business has enormous resources that could be useful in solving social problems. Business has managerial talent, expertise in many technical areas, and physical and financial resources, some of which can be very useful in helping society to alleviate its problems. Business is also known for its innovational ability and its concern for efficient use of resources, which are also required in the social realm. Thus, business ought to be encouraged or even required to try its hand at solving social problems.

(viii) Business has contributed to social problems : There is a moral argument that business has an obligation to help solve social problems because it helped create or at least perpetuate them in the first place. Business causes pollution, it creates unsafe workplaces, and it helps to perpetuate discrimination through its hiring and promotion practices. Therefore, business has a moral responsibility to deal with the negative impacts on society rather than leaving them for someone else to solve. Many social problems are the direct result of business operations, and hence, it is quite appropriate for business to take initiative in solving them.

2.4 Case Against Social Responsibility

Despite the supporting arguments, the concept of social responsibility has been criticised by those who do not support the concept wholeheartedly or simply oppose it on ideological grounds. Some of the arguments given against assumption of social

responsibility by businesspersons are given below:

(i) Profit maximisation: Since business operates in a world of opportunities, the economic efficiency of business is a matter of top priority and should be the sole mission of business. Its function is economic not social, and economic values should be the only criteria used to measure success of business. Managers are the agents of owners (shareholders), and all the decisions in business are governed by the desire to maximise profits while reasonably complying with law and social custom.

(ii) Costs of social involvement: Another argument against social responsibility is the excessive cost of social involvement. Business has very substantial economic resources, but it must use them wisely, otherwise these resources will quickly dwindle into economic redundancy if they are not self renewing. Although business can invest small amounts in meeting social obligations, as it has done in the past, it cannot really commit economic resources for social responsibility unless government or other institutions bear the costs involved.

(iii) Lack of social skill: An additional argument against business assuming social responsibilities is that many businessmen and managers may lack the perception and skills to work effectively with social issues. Their outlook is primarily economic and that their skills are best suited for handling business operations. They really may not feel at home in social matters.

(iv) Dilution of business goals: Involvement of business in social activities may dilute its emphasis on economic productivity, divide the interests of its leaders, and weaken business in the marketplace, with the result that it may accomplish poorly in both its economic and social roles. This implies that society would be a loser in productivity and the economic role of business in society would become confused.

(v) Undermines the free enterprise system: It is argued that the concept of social responsibility is a subversive doctrine that would undermine the principles upon which a free enterprise system is based. For managers to be held accountable for the use of corporate resources to solve social problems, people affected by these decisions would have to be represented at some point in the decision-making process. This could mean that consumers, minorities, women, environmentalists, and so on would all have to be represented on the board of directors, for example. Such a diversity of interests means that decision-making in the corporation would be political rather than economic in nature. Decisions would reflect the political power of these various interests rather than the single objective of economic profitability.

(vi) Corporations are not moral agents: It is sometimes argued that social responsibility is fundamentally a moral concept, and it is difficult if not

impossible for organisations to respond to the moral imperatives inherent in such a concept. People can have moral responsibilities, but not organisations, which are structured to attain certain practical objectives and are basically amoral in their operations. A moral concept such as social responsibility does not apply to organisations because corporations are not moral agents and thus, they cannot be expected to act on moral grounds.

(vii) Reduced international competitiveness: Social responsibility must also be looked at in an international context. If business organisations in India spend significant sums of money to be socially responsible, this expenditure will increase their costs and undoubtedly be added to the cost of their products. If these firms are competing in an international market with firms from other countries that do not have these social costs added to their products, these foreign firms will enjoy an even greater competitive advantage than they already do because of lower wage levels and other factors.

The arguments put forward by the critics of social responsibility suffer from two limitations. Firstly, they require business firms to do something, which they cannot do, i.e., to ignore social demands on them. Secondly, they are over apprehensive of the influence and power which business may exercise through the voluntary assumption of social obligations. In fact, the assumption and discharge of social responsibilities by business is only a matter of time and cannot in fact be avoided. Business is no longer a mere economic institution but also a social institution and businesspersons are trustees of different social groups.

2.5 Social Responsibility towards Different Interest Groups

Even though corporate responsibility for increasing the wealth of owners (Shareholders) is well recognised, other social responsibilities are only beginning to be accepted. A brief list of the many areas is given here in which corporations have acknowledged their social responsibility and established programmes to deal with them.

(i) Natural environment: Responsibility for protecting the natural environment includes judicious use of natural resources, energy conservation, abatement of polluting emissions, and waste management.

(ii) Consumers: Responsibility towards consumers includes production of safe items and using biodegradable packages, educating consumers on product use and disposal, being truthful in advertising, and establishing a procedure for dealing with consumer complaints.

(iii) Employees: Responsibility toward employee welfare includes providing fair compensation and benefits and safe work environment, eliminating discrimination, providing opportunities for personal and

Social Commitments of Indian Companies

A number of Indian companies discharge their social responsibilities quite satisfactorily. There are many companies, which have excelled in such activities but when seen in the light of the country's vast needs, the achievements fall short of requirements. The money spent for social causes by companies is generally, an insignificant proportion of their turnover. Following are few illustrations of such socially responsible Indian companies:

- Asian Paints funded a large scale community development project to enable farmers to use local resources effectively.
- BHEL has contributed to the development of the quality of life in rural areas, health care and family welfare, adult-education, etc.
- Brooke Bond has been interested in animal welfare, providing veterinary service, and improvements in animal breeding.
- Colgate Palmolive did pioneering work in the promotion of sports, dental health, and small industry development.
- Escorts has worked for farm mechanisation, agricultural development, health care etc.
- SAIL contributes to the sectors of agriculture, industry, education, health care, dairy, poultry, fisheries and drinking water supply.
- ITC is socially active in the areas of agriculture, culture, sports and music.
- TISCO has been a pioneer in discharging social responsibility and has made several contributions in areas such as community development, social welfare, tribal area development, agriculture and related activities, rural industrialisation, etc.

professional development, and having progressive human resource policies.

(iv) Government agencies: Responsibilities toward local, state and central government agencies include fulfilling obligations under regulations and statutes of these agencies, cooperating in planning and investigations, and coordinating administrative activities with these agencies.

(v) Community: Responsibilities to the public or communities where the corporation has operations include providing economic stability, safe-guarding public safety, protecting the environment, and aiding in the development of social and cultural resources of the community through corporate philanthropy.

(vi) Media: Responsibilities toward the media include being cooperative and truthful about issues that affect public welfare.

The above discussion reveals that business is under tremendous pressure from several social groups and the interests of these groups are not identical but conflicting. However, businesspersons have proved beyond doubt that they have the required skills and will to reconcile the conflicting interests of all stakeholders and serve them to the best of their satisfaction.

2.6 Human Rights

Human rights provide individuals with autonomy and equality in pursuit of their interests. These rights identify activities or interests that people must be left free to pursue or not pursue as they themselves choose, and whose pursuit must not be subordinated to the interests of others except for special and exceptionally weighty reasons. Human rights provide a basis for justifying one's actions and for invoking the protection or aid of others. They express the requirements of humanity from the point of view of the individual instead of society as a whole and promote individual welfare and protect individual choices against encroachment by society. Even enlightened business houses promote and follow human rights in the pursuit of running their businesses on sustainable basis.

The government of India has also established National Human Rights Commission at national level and its chapters at state level. The important functions performed by the Commission are given on next page.

2.6.1 Case for Human Rights

The notion of rights has recently received much attention in our society. Various movements have appeared to press for the rights of specific groups.

Levi-Strauss Takes a Stand for Human Rights

Levi-Strauss and Company : The world's largest supplier of brand-name apparel, has been exporting jeans and jobs around the world for years, but recently it also decided to export human rights. During the 1980s, Levi paid little attention to working conditions at its contract factories. In fact, in 1991 it was informed that a contractor on the Island of Saipan was keeping imported Chinese women in conditions of near slavery. The contractor was working them 11 hours a day for 7 days a week, paying them below the local minimum wage. Levi terminated that contract. Following that, the company — which exports about 50 per cent of its jeans and shirts overseas — decided to investigate its 400 foreign contractors in 1992: Levi found that about 25 per cent of them were treating their workers badly, and child labour was being used in places such as Bangladesh. After that Levi adopted strict guidelines for its foreign contractors, such as: (i) suppliers must provide safe and healthy conditions that meet Levi's standards; (ii) suppliers must pay workers no less than prevailing local wages; and (iii) company Inspectors will make surprise visits to contractors to ensure compliance.

Functions of Human Rights Commission of India

- Inquire, *suo moto*, or on a petition presented to it by a victim or any person on his behalf, into complaint of (i) violation of human rights or abatement thereof; and (ii) negligence in the prevention of such violation, by a public servant;
- Intervene in any proceeding involving any allegation of violation of human rights pending before a court with the approval of such court;
- Visit, under intimation to the state government, any jail or any other institution under the control of the state government, where persons are detained or lodged for purpose of treatment, reformation or protection to study the living conditions of the inmates and make recommendations thereon;
- Review the safeguards provided by or under the Constitution or any law for the time being in force for the protection of human rights and recommend measures for their effective implementation;
- Review the factors including acts of terrorism that inhibit the enjoyment of human rights and recommend appropriate remedial measures;
- Studies treaties and other international instruments on human rights and make recommendations for their effective implementation;
- Undertake and promote research in the field of human rights;
- Spread human rights literacy among various sections of society and promote awareness of the safeguards available for the protection of these rights through publication, the media, seminars and other available means;
- Encourage the efforts of non-governmental organisations and institutions working in the field of human rights; and
- Such other functions as it may consider necessary for the promotion of human rights.

Examples include the civil rights movement, concern about fundamental rights for blacks and other minorities; women's rights movement developed to press for equal treatment of women in our society; and more recently, right-to-life movement that attempts to protect the rights of unborn children and to oppose abortion. Animal rights movement have affected the testing procedures of business organisations that produce consumer products. Rights have been used extensively as vehicle for the extension of moral consideration to increasing number of groups and entities in society including business. Following are some of the justifications for honouring human rights in society in general and business in particular.

(i) Protection against human injustice: Throughout history, people

have used the notion of rights to overthrow systems of governance and to establish new forms of social and economic power. In the middle ages, Kings claimed a divine right to govern in order to throw off the shackles of the religious leaders and went on to claim ever more extensive powers over the subjects they came to dominate. Fledgling democracies claimed a natural right to liberty as a means to overthrow Kings and to establish a new system of government. Rights seem to emerge as a significant force in history when enough people feel that a basic injustice is being perpetuated, and when these people are able to force a change in society to give them human consideration.

(ii) Provides benchmarks for law and policies: Declaration of independence refers to certain basic rights that are believed to be selfevident; they stem from the nature of things. Such rights can be based on some kind of a natural law concept, that there is an ideal standard of justice fixed by nature that is binding on all persons. This standard takes precedence over the particular laws and standards created by social convention. This concept provides absolute standards against which the laws and policies of particular states and institutions are to be measured.

(iii) Check the sovereign powers of the state: This notion of natural rights may be seen to arise out of a need to check the sovereign power of Kings or the states. However, the rights contained in the Constitution are considered to be fundamental rights irrespective of merit, due to be respected because they are rooted in knowledge of certain universal irregularities in nature.

(iv) Respect the unique properties of human being: Today, we speak more about human rights than natural rights and attempt to promote such human rights throughout the world. Rights are no longer derived from the operations of natural reason, but rather from ideas of what it means to be human. It is assumed that human beings have some kind of an essential nature that

United Nation's Universal Declaration of Human Rights

- The right to work, to free choice of employment, to just and favourable conditions of work, and to protection against unemployment;
- The right to just and favourable remuneration ensuring for the worker and his family an existence worthy of human dignity;
- The right to form and join Trade Unions;
- The right to rest and leisure, including reasonable limitation of working hours and periodic holidays with pay.

determines the fundamental obligations and rights that are to be respected by other people and social institutions. The rights that are asserted as fundamen-tal to the development of humanity are believed to stem from knowledge of these essential properties of human nature.

(v) Overriding significance of human rights over others: A person can only exercise a right to something if sufficient justification exists, that is, if right has overriding status. Human rights are important, normative, justifiable claims or entitlements. Basic human rights cannot be overridden by considerations of utility. Rights can be overridden only by other, more basic rights of some kind. Property rights, for example, can be overridden by a programme of affirmative action to promote equal opportunity, on the basis that equality of opportunity is a more basic human right, because it promotes social welfare. The right to liberty on the part of the employers can be overridden in the interests of the rights of workers to a safe workplace. In this respect certain rights can be considered as fundamental because (a) other rights are derived from them while they are not derived from any more basic rights; and (b) they are preconditions or necessary conditions of all other rights.

(vi) Human rights are independent of legal rights: There is a difference between human and legal rights. One may have a legal right to do something inhuman or a human right without any corresponding legal guarantee. Legal rights are derived from political constitutions, legislative enactments, case law, and executive orders of the highest state official. Human rights exist independently of and form a basis for criticising or justifying legal rights. Legal rights can be eliminated by lawful amendments or by a coup, but human rights cannot be eroded or banished by political voters, powers, or amendments.

(vii) Provides entitlements beyond legal jurisdiction: A right is an individual's entitlement to do something. A person has a right when that person is entitled to act in a certain way or is entitled to have others act in a certain way toward him/her. These entitlements may derive from a legal system that permits or empowers the person to act in a specified way or that requires others to act in certain ways toward that person. Legal rights are limited to the particular jurisdiction within which the legal system is in force. Entitlements can also be derived from a system of human standards independent of any particular legal system. They can be based on human norms or principles that specify that all human beings are permitted or empowered to do something or are entitled to have something done for them. In this case, rights are not limited to a particular jurisdiction. The most important human rights are those that impose prohibitions or requirements on others and that enable individuals to pursue their own interests.

2.7 Business and Environment Protection

During the post-independence period, Indian cities have expanded spatially to accommodate the growing population and increasing economic activities. Absence of effective legal control has also encouraged many air and water polluting industries being set up in urban areas. Although large industries, by and large, have moved away from urban centres, the small and medium sized industries and many others in unorganised sector have continued to conglomerate in big cities, thus, leading to serious environmental problems. For example, clusters of tanneries have come up in Howrah, Kanpur, Ranipat and Vaniambadi and clusters of textile processing industries in Coimbatore, Jaipur, Jodhpur, Pali and Panipat. The tale of national capital, Delhi is worse. It has a record number of 12,355 industries with metal products topping the list and consequently being the most polluted city of the country.

The greatest problem that these industries are creating, is that of air pollution. Their emissions are seriously affecting the health of workers and local residents. The Centre for Science and Environment reported that more than 50000 deaths are taking place in Indian cities every year because of air pollution. Tamilnadu has also recently seen the mushrooming of several saline and freshwater aquafarms, which is being opposed by many, on grounds of environmental and ground water pollution. Harness chloride and alkalinity levels of water collected at 17 points in 7 villages were alarmingly in excess of the prescribed tolerance limits for drinking water. Recently, in Haryana, several industries have been found to dump their liquid hazardous waste, through deep borings, to the groundwater sources resulting in water pollution. Similar state of affairs prevail in other states also.

2.7.1 Causes of Environmental Pollution

Pollution — the injection of harmful substances into the environment — is a significant challenge to contemporary business. Although noise pollution is now attracting increased concern, air, water, and land remain the greatest problems in need of protection from both governments and businesses. A brief explanation of these causes are given below:

(i) Air pollution: Air pollution results when several factors converge to lower air quality. Carbon monoxide emitted by automobiles contributes to air pollution, as do smoke and other chemicals from manufacturing plants.

(ii) Water pollution: Water becomes polluted primarily from chemical and waste dumping. For years, both businesses and cities dumped waste into rivers, streams and lakes with little regard for the consequences.

(iii) Land pollution: There are two key problems in land pollution. The first is how to restore the quality of land that has already been damaged. Land damaged by toxic waste, for example, must be cleaned up for the simple reason that we still need to use them. The second problem, of course, is how to prevent future contamination. New methods of solid waste disposal constitute one response to these problems. Combustible wastes, for example, can now be separated and used as fuels in industrial boilers; exposing waste matter to certain microorganisms can accelerate decomposition.

2.7.2 Need for Pollution Control

The amount of damage to a particular medium (air, water, land) varies by the type of pollutant, the amount of pollutant disposed of, and the distance from the source of pollution. These damages, however, alter the quality of the environment and render it, to some degree, unfit to preserve normal life. Thus, the air can become harmful for human beings to breathe, water unfit to drink, and land unfit to live on because of toxic wastes that begin seeping to the surface posing threat to human health and the environment. Some of the key reasons to control pollution are given below:

(i) Aesthetic objective: To improve the quality of air so that visibility is improved; to prevent pollution from blackening buildings; to reduce the foul odours from streams, rivers, or lakes; to reduce the level of noise so that normal conversation can be carried on; to hide offshore oil derricks behind structures that are more aesthetically pleasing.

(ii) Reducing the nuisance or inconvenience: Polluting a river or lake may make it unfit for fishing or swimming, which could cause displeasure, unhealthy conditions and make it commercially unviable for fisheries. Pollution in the air can cause a certain amount of personal discomfort, such as eye irritation, that may not actually be a health hazard but is something people find uncomfortable. It can also cause serious respiratory problems.

(iii) Economic losses: There are direct economic losses connected with pollution that pollution control could reduce. This can be something as mundane as the soiling of clothes and in this respect a reduction of pollution can reduce cleaning and washing expenses. It is said, for example, that before the days of the Renaissance, in Pittsburg, executives had to take an extra white shirt to work with them in the morning if they intended to go outside the building for lunch. Other economic losses could result from damage to vegetation or livestock, or from deterioration of buildings, particularly in cities where many buildings are irreplaceable works of art.

(iv) Reduce safety hazards: Poor visibility caused by pollution can constitute hazards for aircraft trying to land or take off from airports in the vicinity and for automobiles on

highways. Accidents on the New Jersey turnpike, for example, have been attributed to the poor visibility caused by pollution from refineries and other industrial facilities in the area.

(v) Reduce health hazards: Cancer, heart, and lung diseases have become the leading causes of death in our society, and a growing body of evidence links occurrence of these diseases to pollutants in the environment. Heart disease rates, for example, are known to be higher in areas of high air pollution, and although a direct cause may be difficult to establish, there is increasing evidence that polluted air may aggravate pre-existing heart conditions. Many of the health problems that women face spring from the environs in which they work.

2.7.3 Approaches to Pollution Control

Pollution can be controlled at various fronts. However, handling this problem more systematically is the need of the hour. Some of the more prominent approaches followed to check pollution world over is given below:

(i) Environmental evaluation: The first approach is to require a comprehensive environmental evaluation of an industrial activity before it is undertaken. This would ensure that all primary and secondary effects of such an undertaking are examined and all alternatives considered before the activity is approved. An example of this approach is the environmental impact statement required of all government agencies for projects that affect the environment.

Chemicals Affecting Women and Infants

Chemicals	*Effects*
Lead	Abortion, mental illness
Mercury	Abortion, deformities in infants
Cadmium	Slow development of womb
Selanium	Abortion
Dioxanes	Abortion, birth deformities
Polychlorinated Biphenyl	Slow development, mental illness
Wormicides	Deformities, mutations, abortions
Weedicides	Birth defects
Benzene /Toluene	Anaemia
Carbon monoxide	Brain defects, womb death
Ozone	Abortion, deformities
Anaesthesia	Deformities, childlessness
X-ray	Mutation, mental illness, brain damage, damage to an unborn child.

Major Environmental Pollution Control Activities

- Policy initiatives to improve environment like the National Conservation Strategy and Policy Statement for Environment and Development, 1992, Policy Statement for Abatement of Pollution, 1992, National Forest Policy, 1988, and Environment (Protection) Act 1986.
- Notification and implementation of emission and effluent standards for air, water and noise levels. Standards are formulated by a multidisciplinary group keeping in view the international standards, existing technologies and impact on health and environment.
- Identification and Action Plans for 17 categories of major polluting industries.
- Identification of 24 critically polluted areas for pollution abatement and improving environment.
- Use of beneficiated coal with an ash content not exceeding 34 per cent irrespective of their distance from pit head.
- Action Plans for 141 polluted river stretches to improve quality of river water.
- For controlling vehicular pollution, progressive emission norms at the manufacturing stage have been notified, cleaner fuels like unleaded petrol, low sulphur diesel and compressed natural gas (CNG) introduced.
- Identification of clean technologies for large industries and clean technologies/processes for small scale industries.
- Setting up of 'Common Effluent Plants' (CETPs) for clusters of SSI units.
- Implementation of an Eco-mark scheme to encourage production/consumption of environment friendly products.
- Preparation of a Zoning Atlas, indicating status of the environment at district levels to guide environmentally sound location/citing of industries.
- Mandatory submission of annual Environmental statement which could be extended into environmental audit.
- Initiation of environmental epidemiological studies in seven critically polluted areas to study the impact of environment on health.
- Provision of fiscal incentives for installation of pollution control equipment and also for shifting of industries from congested areas.
- Setting up of authorities like the Environment Pollution (Prevention and Control) Authority for the National Capital Region for protecting and improving the quality of environment and preventing, controlling and abating environmental pollution.
- Banning of smoking in public places and use of polythene bags.

(ii) Setting up of pollution standards: For specific types of pollutants, these standards set limits on the maximum allowable level of the pollutants. Air pollution is controlled in this manner. Euro II emission norm in case of small cars manufactured in India is the most known example of pollution standards.

(iii) Regulation: Regulate industrial and municipal discharge activities through licensing procedures, granting these facilities permission to discharge pollutants or waste by using certain broad types of technology available or by following certain procedures. Except for particularly hazardous substances (such as mercury) water pollution is controlled in this fashion.

(iv) Ban: This approach examines substances before they are used to determine whether they are safe or whether they constitute such a hazard that their use needs to be limited or banned. Toxic substances control legislation is an example of this technique.

2.7.4 Environment Protection Regulations

The Bhopal gas accident gave rise to a new classification of industries i.e., those having the potentiality of major accidents, with direct consequences on human life and the environment. It has also revealed several loopholes in Indian environmental legislation. All these prompted the government of India to bring major changes and frame new enactments and rules.

2.8 Business Ethics

Concept

An act, decision, or behaviour is ethical if it is in conformity with prevailing norms or standards of society.

A number of issues are raised by this definition. One issue, which is implicit, is the question of whether there are absolute standards or whether ethics always entails a relative judgement compared with prevailing norms of society. There are many people who believe that there are ethical absolutes. On the other hand, many recognise that over time many standards of behaviour have changed in our society, even though there may be a small set of absolutes we could agree upon. Most standards have gotten tighter in the business environment. Examples of standards that have become more stringent for business include expectations about the treatment of people, protection of environment, safety standards in the workplace, product safety, and employees' rights. In each of these cases we can see how standards or norms have changed over time.

Another major issue with our definition when we refer to prevailing norms or standards of society is the question: Whose norms or standards are we referring to? Are we referring to norms established by society, the individual, our superiors, our family or friends, the profession or industry we are in, our religion, or our community? Actually, these are all appropriate answers in varying

circumstances. Certainly a minimum standard is that reflected in the law. But, when we talk about ethics involving a level of behaviour higher than the law, a number of questions mentioned above come into play. Each of us must be responsive to a variety of prevailing norms.

Ethics involves critical analysis of human acts to determine whether they are right or wrong in terms of two major criteria: truth and justice. Listed below are several behaviours that indeed might be unethical by the criterion of truth.

- Falsifying time / quality/ quantity reports;
- Claiming credit for someone else's work;
- Reporting sick to take a day off when one is not sick;
- Concealing one's errors.

Below are several behaviours that might appropriately be judged unethical by the criterion of justice.

- Pilfering company materials and supplies;
- Using company services for personal use;
- Accepting gifts / favours in exchange for preferential treatment;
- Doing personal business on company time.

However, the practical implications are far more controversial, and sincere and ethical individuals have serious problems in agreeing on how far the prohibition of murder, for instance, includes killing

- in defence of your own life;
- a burglar breaking into your house;
- an enemy soldier in time of war;
- an enemy civilian in time of war;
- animals, for pleasure.

Deciding between right and wrong is not easy when different ethical values are in conflict. An illustration is provided by the case of an entrepreneur, nearly 80 years old, whose empire included real estate, a packaging plant, a textile mill and 37 shopping centres, which were originally based on brothels — of which she still owned 11. She commands more respect than ever for her individualist streak, her fierce loyalty to the state, her generosity toward the poor, and the fact that she paid about Rs 90 lakh income tax in one year. So should she be praised for her patriotism, charity, and fiscal honesty, or condemned for profiting from prostitution? If condemned, should you do business with her? However, the local people were unwilling to accept charity for religious causes from her.

Many people have defined business ethics differently. One of the definitions of ethical business behaviour is any business decision that creates value for the customer by matching quality with price. Thus, ethical decisions are expected to (i) provide the customer with valid data about the product and service; (ii) enable the customer to make free and informed choice; and (iii) generate customer commitment to the product and the organisation that provides it.

Violation of these three rules implies unethical behaviour — invalid and false data, coerced and manipulated decisions, and low integrity and poor reputation for the firm.

2.8.1 Ethics vs. the Law

We have made reference to ethics versus the law in the previous paragraph and said that ethical behaviour is above behaviour required by law. This is the generally, accepted view of ethics. We should make it clear, however, that in many respects the law and ethics overlap. To appreciate this, you need to recognise that the law embodies notions of ethics. That is, the law may be seen as a reflection of what society thinks are minimum standards of conduct and behaviour. Both law and ethics have to do with what is deemed right or wrong, but law reflects society's codified ethics. Therefore, if a person breaks a law or violates a regulation, he/she is also behaving unethically. In spite of this overlap, we continue to talk about desirable ethical behaviour that extends beyond what is required by law. Viewed from the standpoint of minimums, we would certainly say that obedience to law is a minimum standard of behaviour. In addition, we should make note of the fact that the law does not address all realms in which ethical questions might be raised.

Citings

Business Ethics

Christopher Cowton & Roger Crisp

Many thinkers deny the possibility of businessmen having responsibilities or ethical obligations. A businessman has no alternative, in view of the competition of the marketplace, to do anything other than buy at the cheapest and sell at the dearest price he can. In any case, it would be irrational if, indeed, it were possible not to do so. Admittedly, there is a framework of law within which he has to operate, but that is all, and so long as he keeps the law he is free to maximise his profits without being constrained by any moral or social considerations, or any further sense of responsibility for what he does.

This view is mistaken. Economic determinism is false. The iron laws of supply and demand are not made of iron, and indicate tendencies only, without fixing everything, leaving no room for choice. In economic affairs we are often faced with decisions, and often can choose between a number of alternative courses of action. It is up to us what we do; we are responsible agents, and may fairly be asked to explain why we did as we did.

Nor do canons of rationality pick out one single course of action as the only rational one to take.

Source : The Economic Times

2.8.2 Elements of Business Ethics

Business people must come to appreciate the key elements that comprise making ethical judgments. This is a central notion in moving from the unethical business condition to the ethical business one. There are six major elements or capacities that are essential in making ethical judgments.

(i) Ethical imagination: Developing ethical imagination means being sensitive to ethical issues in business decision-making, and ability to identify those situations where people are likely to be detrimentally affected by decision-making.

(ii) Ethical identification and ordering: It refers to the ability to judge the relevance or non-relevance of ethical factors in decision-making situations. In addition to their identification, ethical issues must be ranked. Several decision situations in which ethical identification and ranking have become important in recent years include the issue of continuing business or plant closure, the status of employees' *rights to know* what toxic chemicals they are being exposed to.

(iii) Ethical evaluation: To evaluate ethical factors business persons have to develop clear principles, basis of weighing those factors, and the ability to make out the likely ethical as well as economic outcomes of a decision.

(iv) Tolerance of ethical disagreement and ambiguity: One of the principal objections to ethics is the extent of disagreement and ambiguity that is tolerated in thinking ethically. This must be accepted because there is no other way. For example, introducing a new product based upon limited test marketing, may be a critical decision, but businesspersons have become accustomed to making them in spite of the disagreement and ambiguity among those involved in the decision.

(v) Integration of managerial and ethical competence: Ethical competence is an integral part of managerial competence. Business

Tata Steel : They Did It First

The Measure	*At Tata Steel*	*In the Law Books*
Eight-hour working day	1912	1948
Free medical aid	1915	1948
Welfare department	1917	1948
Committee for worker complaints	1919	1947
Leave with pay	1920	1948
Provident fund	1920	1952
Maternity benefits	1928	1946
Profit sharing bonus	1934	1965
Retiring gratuity	1937	1972

Elements of Business Ethics

Right to know: A reputed company's manufacturing operations was emitting toxic substances in the air. Residents around the locality were falling sick and dying. The company was aware of the environmental decay it was spreading but would systematically destroy all damaging records and evidence. Years later when the residents filed a suit against it for having caused deformation, chronic illness and death, the company denied having knowledge of the environmental damage it had been causing. Eventually, it was proved that the company in fact was aware of the harmful consequences of their actions on the health of the local people. The relevant question here is that did the residents not have the right to know that they were being subjected to toxic chemicals.

Measuring ethical and economic outcomes: Anita is a sole proprietor who owns a handicraft export unit with no domestic sales. Typically Anita gets orders which get executed and completed in three to four months every year. For the remaining eight to nine months there is no work and no production in the unit. This period is used to develop new samples to get orders in the next year.

Anita is faced with a difficult dilemma involving ethics and economics. For three to four months she needs hundred workers to execute orders. For the remaining eight to nine months she needs only around five workers. If she employs all hundred workers for the entire year costs increase so much that she cannot successfully quote for export contracts.

Integration of managerial and ethical competence: A business that treats employees fairly, pays taxes honestly to the government, uses quality raw materials in its product, invariably passes on the cost to the consumer in the form of higher prices. Here, the business is able to take care of only three ethical perspectives but is not able to charge a lower price. If the company or the proprietor is able to charge a price which is affordable or acceptable to the consumer i.e., gives value for money, then another ethical perspective of providing "value for money" can be integrated.

The manager's managerial skills will come into play when she is able to holistically integrate all the ethical perspectives i.e., treat employees fairly, pay taxes, use quality raw materials and charge a fair price. Here she has to integrate managerial and ethical competence. If there are still further surplus profits she may set up a school or hospital for the underprivileged. By doing so she discharges her social responsibility toward society. Ethics does not mean looking after interest of consumers and society but also displaying managerial competence so as to run the business successfully.

persons must be conscious that there is a price to pay for unethical behaviour. The ethical businessperson sees every evolving decision as one in which an ethical perspective must be integrated.

(vi) A sense of ethical obligation: This refers to the intuitive or learned understanding that ethical fibres — a concern for fairness, justice, and due process to people, groups, and communities should be woven into the fabric of managerial decision-making.

Finally, a socially profitable business is one that provides society both economic and social net gain in relation to inputs (costs). Society expects business to give increased attention to its social profitability.

SUMMARY

Social responsibility means obligations of the businesspersons to pursue those policies that help society in achieving its objectives and values.

Case for social responsibility : This arises out of: (a) changed public expectations from business; (b) better environment for business; (c) public image; (d) avoidance of government regulation; (e) problems can become profits; (f) balance of responsibility with power; (g) business has useful resources; and (h) business has contributed to social problems.

Case against social responsibility: Some of the arguments against it are: (a) profit maximisation; (b) costs of social involvement; (c) lack of social skill; (d) dilution of business, primary purpose; (e) undermine the free enterprise system; (f) corporations are not moral agents; and (g) reduced international competitiveness.

Social responsibility towards different interests groups: In more specific terms, businesspersons have social responsibility towards: (a) investors; (b) natural environment; (c) consumers; (d) employees; (e) government agencies; (f) community; and (g) media.

Human rights: They provide individuals with autonomy and equality in the free pursuit of their interests. Such rights have universal acceptance. Companies that have followed human rights during their operations have been immensely benefited. The main justifications for their observing are: (a) growing awareness about rights; (b) protection against human injustice; (c) benchmark for framing laws and policies; (d) check on misuse of sovereign powers; (e) overriding status of human rights over other rights; (f) human rights are independent of legal rights; and (g) provides entitlements to act beyond legal jurisdiction.

Environmental pollution: This has become a major problem for society. It is spreading beyond human tolerance. The main causes are: (a) air; (b) water; (c) land; and (d) noise. The need to check pollution arises out of: (a) aesthetic

objective; (b) reducing the nuisance; (c) economic losses; (d) reduce safety hazards; and (e) reduce health hazards. The approaches followed to check pollution controls are: (a) environmental evaluation; (b) setting up of pollution standards; (c) regulation; and (d) ban. Government of India has also promulgated number of acts and formulated number of policies to check pollution.

Business ethics: It is an act, decision or behaviour if it is in agreement with prevailing norms or standards of society. It is different from the law. In business terms, ethical decisions provide the customer: (a) valid data about the product and service; (b) free and informed choice; and (c) an opportunity to generate greater commitment to the product and the organisation that provides it. The basic elements of ethical decisions are: (a) ethical imagination; (b) ethical identification and ordering; (c) ethical evaluation; (d) tolerance of ethical disagreement, and ambiguity; (e) integration of managerial and ethical competence; and (f) a sense of ethical obligation.

EXERCISES

Short Answer Type Questions

1. Explain the concept of social responsibilities of business.
2. Define business ethics.
3. How is business ethics different from law?
4. What is meant by human rights?
5. What is environmental pollution?
6. What are the major causes of environment pollution?
7. What is the major area of social responsibilities with which business should be concerned?

Long Answer Type Questions

1. Examine the case for social responsibilities of business.
2. "Business is not merely profit making enterprise but essentially a social institution." Explain.
3. Explain briefly the social responsibilities of business enterprise towards: (a) Employees; (b) Consumers; (c) Environment; (d) Investors.
4. "Like an individual, business enterprise should also be loyal citizen of the state." Discuss.
5. Explain the elements of business ethics.
6. What steps has business taken to protect the environment from the dangers of pollution?
7. In what way do you think the human rights movement might actually benefit business.
8. In your opinion, is India spending too much, too little, or just about the right amount to prevent pollution and clean up the environment?

Project Work

Title	:	Inquiry into the ethics of running business.
Objective	:	Encourage students to understand the concept of ethics and its critical role in business decisions.
Coverage	:	Honest and trustworthy in all your relations, reliable in carrying out assignments and responsibilities, truthful and accurate in what we say and write, fair and considerate in our treatment of fellow employees, customer, etc., economical in utilising company resources, etc.
Material	:	Questionnaire
Methodology	:	Let each student interview (through questionnaire) one businessperson/business manager and ask how he/she pursues ethics in their business decisions. Interpret their scores with the help of the instructor and draw conclusions.

Questionnaire

The solutions to many day-to-day questions in business are not simply right or wrong. Rather, they fall into a grey area. To demonstrate the perplexing array of moral dilemmas faced by businessperson, here is a test. Give it a try, and see how you score. In the box to the right of each statement, mark **0** if you strongly disagree, **1** if you disagree, **2** if you agree, and **3** if you strongly agree.

Sl. No.	*Statements*	*Strongly Disagree*	*Disagree*	*Agree*	*Strongly Agree*
1.	It is okay to withhold negative information about a product in order to make a big sale as long as the negative aspect is not dangerous or life threatening.	☐	☐	☐	☐
2.	There are times when a manager must overlook contract and safety violations in order to get on with the job.	☐	☐	☐	☐
3.	It is not always possible to keep accurate expense records. Therefore, it is sometimes necessary to give approximate figures.	☐	☐	☐	☐

Sl. No.	Statements	Strongly Disgaree	Disagree	Agree	Strongly Agree
4.	There are times when it is necessary to withhold embarrassing information from the boss.	☐	☐	☐	☐
5.	We should do what our managers suggest, even though we may have doubts about its being the right thing to do.	☐	☐	☐	☐
6.	It is sometimes necessary to conduct personal business on company time.	☐	☐	☐	☐
7.	Taking a friend to lunch and charging it to the company as a business expense is acceptable as long as the bill is reasonable and doing so does not become a regular habit.	☐	☐	☐	☐
8.	I would quote a *hopeful* shipping date to get an order.	☐	☐	☐	☐
9.	It is proper to use the company WATS line for personal calls as long as it is not being used for company business.	☐	☐	☐	☐
10.	Management must be goal-oriented. Therefore, the end usually justifies the means.	☐	☐	☐	☐
11.	If providing heavy entertainment and twisting company policy a bit would win a large contract, I would authorise it.	☐	☐	☐	☐
12.	Inventory controls should be designed to report *underages* rather than *overages* in goods received.	☐	☐	☐	☐
13.	Occasional use of the company's photocopying machine for personal use or community activities is acceptable.	☐	☐	☐	☐

Sl. No.	*Statements*	*Strongly Disgaree*	*Disagree*	*Agree*	*Strongly Agree*
14.	Taking home company property (pencils, paper, tap, and the like) for personal use is an accepted fringe benefit.	☐	☐	☐	☐

If the total score is:

Possible saint	00-00
High ethical values	01-10
Good ethical values	11-15
Average ethical values	16-25
Deficient ethical development	26-35
In trouble	36-44
Jailbird	45 —

CHAPTER 3

Structure of Business

LEARNING OBJECTIVES

After studying this chapter, you should be able to :

- identify the different types of industries;
- classify the activities included in commerce;
- explain the opportunities and benefits of e-commerce;
- state the resources required for e-commerce;
- analyse the reasons for outsourcing of services.

3.1 Introduction

In the previous chapter we have discussed the evolution of business activities in India resulting in the growth of modern industries, transport, banking and insurance. Now, we shall study how these business activities are classified and grouped together in categories to form part of the broad structure of business.

Structure means the way in which something is organised, built or put together. Structure of business refers to broad categories of activities which together constitute business. To study the structure of business it is therefore, necessary to understand various categories or classes of business activities. Classification of business activities may be done on the bases of size, ownership and function. In other words, structure of business may be viewed in terms of size, ownership and function.

3.2 Classification of Business Activities

On the basis of size, structure of business may be said to consist of small scale and large business units. The small scale units operate on a small scale. Their production or sales are relatively small. These require less capital, employ small number of workers, and often serve smaller number of customers or clients. Goods like ice cream, knitwear's, emergency lamps, bicycle parts, sports goods, and stationery items like pens, pencils, sharpeners, etc. are produced by small units. Some small scale units produce parts or components for large scale units. Such units are known as ancillary units. Large scale units in contrast call for substantial investments, which are used to purchase, install and operate big and sophisticated machinery. They employ a large number of workers and produce on a large scale. Iron and steel, cement, petrochemicals and automobile manufacturing units are examples of large scale business.

On the basis of ownership, business structure may be viewed as consisting of public sector units and private sector units. If a business is owned by government or any of its agencies, it is known as a *public sector enterprise*. Where ownership of business is in the hands of person other than government, it is a *private sector enterprise*. A few enterprises are owned partly by government and partly businessmen directly or indirectly. They are called *joint sector enterprises*.

Private business firms are organised in several forms. They include sole proprietorship, partnership, joint Hindu family, joint stock company, and cooperative society. A public enterprise may be organised as a departmental undertaking, statutory corporation, or government company. Joint sector enterprises are normally in the form of companies.

On the basis of function, we may study business activities as consisting of industry and commerce. Industry is concerned with the production or

processing of goods and materials. Commerce includes all those activities which are necessary for facilitating the exchange of goods and their storage and distribution. On the basis of these two categories, we may classify business firms into *industrial enterprises* and *commercial enterprises*. The goods produced by an industrial enterprises may be either for final consumption by consumer or for use in other industrial enterprises for further production. In the former case, they are called *consumer goods*. For example, bread, butter, cheese, sugar, textiles, shoes, radio, TV, etc. are consumer goods. On the other hand, production of machinery or machine-tools by an engineering firm are called *capital goods*. It is because they are used by other industrial enterprises for manufacturing consumer goods. Commercial enterprises include trading and service activities like transport, banking, insurance, warehousing and advertising. These services are also referred to as auxiliaries to trade.

Let us examine the activities relating to industry and commerce.

3.3 Industry and Its Types

Industry refers to economic activities which are connected with conversion of resources into useful goods. The term industry is used for activities in which mechanical appliances and technical skills are involved. These include activities relating to producing or processing of goods as well as breeding and raising animals. In a broad sense, the term *industry* is also used to mean groups of firms producing similar or related goods. For example, cotton textile industry refers to all manufacturing units producing textile goods like cloth, etc. from cotton. In common parlance certain services like banking and insurance are also referred to as industry, say banking industry, insurance industry etc.

Industries may be divided into three broad categories: primary industries, secondary industries and tertiary industries. Primary industries include all those activities, which are connected with the extraction and production of natural resources and reproduction and development of living organisms, plants etc. These industries may be further sub-divided as follows:

(i) Extractive industries; and
(ii) Genetic industries.

Secondary industries are concerned with the materials which have already been extracted at the primary stage. These industries process such materials to produce goods for final consumption or for further processing by other industrial units. For example, the mining of iron ore is primary industry, but manufacture of steel is secondary industry. Secondary industries may be of two types:

(i) Manufacturing industries; and
(ii) Construction industries.

Tertiary industries are concerned with providing support service to primary and secondary industries as

well as activities relating to trade. These industries provide service facilities. As business activities these may be considered part of commerce also because as auxiliaries to trade they assist trade. Included in this category are transport, banking, insurance, and others like warehousing, communication, packaging and advertising.

(i) Extractive industries: Extractive industries are those which involve extraction of something from natural sources like timber from forests, fish from rivers and seas, and minerals from under the earth. Their products include timber, fish and various minerals like coal, iron ore, lime stone, etc. In such cases, the products are either directly consumed or are used as raw materials for further treatment. For example, fish is often directly consumed, coal is used as a fuel, while minerals are used as raw materials to produce various goods. These activities were carried out manually in the past. However, with the passage of time, machines have come into use in some of these industries like mining, which is highly mechanised.

(ii) Genetic industries: These are primary industries which include activities connected with rearing and breeding of animals and birds and growing plants. Reproduction and multiplication of certain species is the main activity in these industries. Examples of these industries are:

- Agricultural activities for growing crops.
- Animal husbandry which may include rearing of cattle for milk, grazing sheep for wool and mutton etc.
- Dairy farming like using milk from cattle to produce butter, cheese, etc.
- Poultry farming which may include raising birds (hens and ducks) for meat and eggs.
- Pisciculture, i.e. growing fish in ponds, canals and rivers.
- Orchards or farms to grow different fruit trees like apples, cherries, grapes, etc.
- Floriculture, vermiculture, sericulture

(iii) Manufacturing industries: These are known as secondary industries which convert raw materials into finished products, for example, cotton or jute into textile, timber into furniture, iron-ore into steel, and so on. Essentially, they change the form of goods (raw materials) and, thus, create *form utility*. These industries may be run on a small scale using simple tools and equipments or on a large scale using power driven complex machinery. Manufacturing enterprises produce the following:

- Consumer goods like cloth, soap, hair oil, stationery, etc. which are used for day-to-day consumption.
- Intermediate goods like steel, cement, chemicals etc. which are needed for other production activities.
- Capital goods like machinery and equipment, which are required to manufacture consumer and intermediate goods.

(iv) Construction industry: Activities concerned with building houses, roads, bridges, dams, seaports, aerodromes, etc. belong to the category of construction industry. The peculiar feature of these activities is that output does not consist of movable goods. Construction industries make use of the output of various others industries, like bricks, sand, cement, steel, etc. Construction activities are labour intensive by nature. However, in big construction works, the use of heavy machines like cranes, bulldozers, etc., is increasing.

3.4 Commerce

Commerce includes two types of activities first, all those business activities, which are undertaken for the sale or exchange of goods. These are termed as trade. Second, various services that facilitate trade. These are called services or auxiliaries to trade and include transport, banking, insurance, communication, advertisement, packaging and warehousing. Commerce provides the necessary link between producers and consumers. It embraces all those activities which are necessary for maintaining a free flow of goods and services. Commerce is, thus, defined as activities involving the removal of hindrances in the process of exchange. The hindrance of persons is removed by trade thereby making available goods to the consumers from the producers. Transport removes the hindrance of place by moving goods from the places of production to the markets for sale. Storage and warehousing activities remove the hindrance of time by facilitating holding of stocks of goods to be sold as and when required. Goods held in stock as well as goods in course of transport are subject to the risks of loss or damage due to theft, fire, accidents, etc. Protection against these risks is provided by insurance of goods. Capital required to undertake the above activities is provided by banking and financing institutions. Advertising makes it possible for producers and traders to inform consumers about the goods and services available in the market. Hence, commerce is said to consist of activities removing the hindrances of persons, place, time, risk, finance and information in the process of exchange of goods and services.

It should be clear from the above that the term *commerce* includes a wide range of activities connected with sale or exchange of goods and services. The functions of commerce, therefore, may be outlined as follows:

(i) A large variety of goods which are produced regularly are meant for consumption by people living in different areas. This requires procurement of goods from the producers for sale to the ultimate consumers. Traders help the exchange of goods by acting as a link between the producers and the consumers. Trade is indeed the most important branch of commerce as it relates to the transfer or exchange of goods and

services. Buying and selling of goods which take place in trading activities constitute the most important function of commerce.

(ii) Production of goods is carried out in particular places whereas consumers are scattered in different cities, towns and villages. Goods must, therefore, be moved from the place of production to the various markets. Transportation by road, rail, water and air helps the process of movement without which the sale of goods to consumers would be impossible. Thus, transport is essential for buying and selling of goods, and is an important function of commerce.

(iii) In modern societies, production generally, takes place in anticipation of demand. Hence, goods which are produced continuously must be held in stock and made available for sale as and when necessary. This function is performed through arrangement for storage of goods in warehouses. Hence, warehousing is regarded as another essential function of commerce.

(iv) Insurance of goods and property, movable or immovable, is required to cover the risks of loss or damage due to fire, theft, accident and natural calamities. Traders are able to protect themselves against these risks by insuring goods and building on payment of a nominal amount of premium to the insurance company. Insurance as a branch of commerce is as important as the others.

(v) Trading activities require funds for procurement and storage of goods before they are transferred. Besides investing their own capital, it is often necessary for them to borrow money. Loans provided by banks and financial institutions are helpful whenever, traders are in need of additional funds. Banking as a part of commercial activities is actually responsible for increasing the volume of trade.

(vi) Consumers must be aware of the variety of goods available in the market before making their purchase. It is therefore, necessary that information relating to the goods and services produced must reach the public. One of the common methods of providing information about goods on sale is advertising. As a branch of commerce, advertising helps in bringing all types of goods to the notice of consumers.

3.5 Trade and Its Types

Trade is an integral part of commerce. It refers to sale, transfer or exchange of goods. It helps goods produced being made available to ultimate consumers. These days goods are produced on a large scale and it is difficult for producers to reach individual customers for sale of their products. Businessmen are engaged in trading

activities as middlemen to make the goods available to consumers in different markets. Trade is said to remove the hindrance of persons, that is, of consumer and producer. In the absence of trade, production on a large scale would have been impossible to undertake. Trade has taken place mainly due to increasing volume and variety of goods.

Trade may be classified either on the basis of volume of business or on geographical basis. For example, when goods are purchased in bulk from the producers for resale to retailers it is known as *wholesale trade*. Those who are engaged in this trade are known as *wholesalers*. On the other hand, when goods are bought in comparatively small quantities either from the wholesalers or manufacturers to be sold to ultimate consumers, it is known as *retail trade*. Businessmen are known as *retailers* when they undertake retail trade. On geographical basis, trade may be classified as *internal trade* or *external trade*. When goods are exchanged within the geographical boundaries of the country, it is known as *internal trade* whereas, goods purchased from or sold to a foreign country is known as *foreign trade*. If goods are purchased from a foreign country it is called *import trade*. If they are sold to other countries, it is known as *export trade*. When goods are imported for export to other countries, it is known as *entrepot trade*. Let us discuss briefly the nature of various types of trades.

3.5.1 Internal Trade

Internal trade is also known as domestic trade or home trade or inland trade. It consists of sale, transfer or exchange of goods within a country. This type of trade facilitates movement of goods from points of production to areas where they are needed. Transfer of goods from one region to another region helps to bring uniformity of prices. It also serves a social purpose by creating a feeling of oneness among the people of different regions and harmonises cultural differences.

Growth of domestic trade depends upon the development of internal transport system — roads, railways, airlines, inland waterways and coastal shipping. Usually, movement of goods takes place by road and rail transport. The volume of trade also depends upon the size of population, volume of production, development of banking and other support facilities. Above all, political stability and economic policies of the government are the other environmental factors which influence the growth of the following trade.

(i) Wholesale trade: The trade involves buying goods in bulk from producers and selling them in small quantities to retailers. Wholesalers undertake the responsibility of procuring and storing large quantities of goods for supply to the retailers as and when required by them. The wholesaler serves as an important link between the manufacturer and the consumers through retailers. He/she provides information to the

manufacturers on the demand for goods, customer preferences, competition etc. The wholesaler receives commission from the manufacturer on goods purchased. A wholesaler may procure goods from one or more manufacturers, although he/she may specialise in particular types of products.

(ii) Retail trade: This refers to sale of goods in small quantities directly to consumers. Retailers usually purchase goods from whole-salers. Sometimes, they purchase from manufacturers directly. They are a vital link between manufacturers and consumers. It is they who sell goods to the ultimate consumers and generate goodwill for manufacturers through the wholesalers.

Retailers may stock different types of goods of the same manufac-turer or similar goods of different manufacturers. They may also specialise in a line of goods, e.g., food grains, books, stationery, leather, etc.

3.5.2 External Trade

External trade, also known as foreign trade, consists of trade among different countries. It involves import and export of goods. It facilitates countries to specialise in the production of goods for which they have maximum relative advantage. This helps all trading countries derive the benefits of specialisation. The movement of goods takes place usually by sea wherever possible. In adjoining area, rail and road transport may be used. Air transport is used for goods of small bulk and high value.

Foreign trade — import or export depends upon government policies in the trading countries and usually requires a number of formalities to be completed. There are often restrictions imposed on free entry of goods and duties and taxes are to be paid. Besides, the foreign exchange earned by an exporter has to be either surrendered to Reserve Bank of India in exchange of Indian currency or used in the manner prescribed in law. On the other hand, importers have to obtain foreign exchange from the Reserve Bank of India. Violation of laws relating to import, export or foreign exchange invites punishment.

A developed banking system is very useful in foreign trade. Our commercial banks provide numerous services to the importers as well as the exporters. Government policies are also in favour of export promotion.

3.5.3 Auxiliaries to Trade

Activities which are meant for assisting business are known as *auxiliaries* to business. These activities are generally, referred to as services also because these activities are in the nature of facilitating the activities relating to industry and trade. Transport, banking, insurance, warehousing, and advertising are regarded as auxiliaries to trade, i.e. activities playing a supportive role. In fact, these activities not only support trade but also industry and hence, the entire business activity. However, auxiliaries

are an integral part of commerce in particular and business activity in general. These activities help in removing various hindrances which arise in connection with the production and distribution of goods. Transport facilitates movement of goods from one place to another. Banking provides financial assistance to the traders. Insurance covers various kinds of business risk. Warehousing creates time utility with storage facility. Advertising provides information. In other words, these activities facilitate movement, storage, financing, risk coverage and sales promotion of goods. Auxiliaries to trade are briefly discussed below:

(i) Transport and communication: Production of goods generally, takes place in particular locations. For instance, tea is mainly produced in Assam, cotton in Gujarat and Maharashtra, jute in West Bengal and Orissa, sugar in U.P., Bihar and Maharashtra, and so on. But these goods are required for consumption in different parts of the country. The obstacle of place is removed by transport — road, rail or coastal shipping. Transport facilitates movement of raw materials to the place of production and the finished products from factories to the place of consumption.

Along with transport facility, there is also need for communication facilities so that producers, traders and consumers may exchange information with one another. Thus, postal services and telephone facilities may also be regarded as auxiliaries to business activities.

(ii) Banking and finance: Business activities cannot be undertaken unless funds are available for acquiring assets and meeting the day-to-day expenses. Necessary funds can be obtained by businessmen from banks. Thus, banking helps business activities to overcome the problem of finance. Commercial banks generally, lend money by providing overdraft and cash credit facilities, loans and advances. Banks also undertake collection of cheques, remittance of funds to different places, and discounting of bills on behalf of traders. In foreign trade, payments are arranged by commercial banks on behalf of importers and exporters. Commercial banks also help promoters of companies to raise capital from the public.

(iii) Insurance: Business involves various types of risks. Factory building, machinery, furniture etc. must be protected against fire, theft and other risks. Materials and goods held in stock or in transit are subject to the risks of loss or damage. Employees are also required to be protected against the risks of accident and occupational hazards. Insurance provides protection in all such cases. On payment of a nominal premium, the amount of loss or damage and compensation for injury, if any, can be recovered from the insurance company.

(iv) Warehousing: Usually, goods are not sold or consumed immediately after production. They are held in stock

to be available as and when required. Special arrangements must be made for storage of goods to prevent loss or damage.

Warehousing helps business firms to overcome the problem of storage and facilitates the availability of goods when needed. Prices are thereby maintained at a reasonable level through continuous supply of goods.

(v) Advertising: Mass consumption goods like electronic goods, automobiles, soaps, detergents, are manufactured and supplied in the market by numerous firms — big or small. It is practically impossible for producers or traders to contact each and every consumer. Thus, for sales promotion, information must reach the potential buyers about the goods available in the market. Goods are advertised to inform consumers about their uses, quality, price etc. Advertising, thus, helps in providing information about available goods and inducing consumers to buy particular items.

3.6 E-Commerce

One of the major causes of change in the life of human beings has been technology. A major technological breakthrough in recent years has been computer application. Computers have influenced the speed and mode of carrying out a large number of activities. Recently, these have increasingly been employed by business enterprises to carry out many business activities. Internet is being extensively employed for information transfer, reaching the customers, making payments, advertising the products, recruiting employees, buying raw-materials, etc. A large number of business activities are thus, being carried out electronically through computers and internet. In a broad sense the carrying out of business activities through internet has come to be known as *e-commerce*. Narrowly defined, e-commerce is concerned with reaching out to the customers and conducting sales activities through internet.

Electronic commerce thus, refers to all forms of business transactions which are based on electronic processing and transmission of data including text, sound and visual images. E-commerce can take place within or among three groups of economic actors namely business, government and individuals. The business transactions take place electronically within and among these three groups. The transactions taking place amongst business units are referred to as business to business transactions, popularly called B2B transactions. These transactions often involve carrying out commercial negotiations, information sharing, collaborative work etc. The transactions taking place between business and individual customers are known as business to customers or B2C transactions. The focus of these transactions is carrying out various activities which are involved in selling and after sales services electronically,

mostly through internet. At present by and large, most e-commerce activities take place at B2B and B2C and level, although there is tremendous scope of e-commerce activities taking place at business to government and government-to-individual level. Such a scope lies in payment of taxes, and duties, obtaining information on government policies, etc. The process in this respect has already begun.

3.6.1 Opportunities and Benefits of E-Commerce

E-commerce offers tremendous opportunities for business enterprises to expand their sales and strengthen business to business relationships. Increasingly larger numbers of people are making use of internet. It is expected that gradually people will prefer to do shopping online, through the internet because of the convenience of being able to shop from home offered by it. According to an estimate, millions of people around the world exchange information or do deals through this medium. The numbers are on the increase. *Secondly*, the business enterprises can display three dimensional images of their product on the internet and reach out to each and every human being on this planet who has access to internet. The whole world

E-Commerce B2B Activity — More Corporates Log on

Driven by the need to cut costs, Indian companies have taken to e-procurement in a big way. Telco, Hindustan Motors, Coke, Hindalco and many others have managed to save 5 to 10 per cent of their procurement cost by going online. Through e-procurement, companies can reduce the number of suppliers and even discover new suppliers from low cost regions around the world.

E-procurement is defined as any transaction a part of which is carried out over the internet. This could involve placing orders online with suppliers or buying through an online auction for cheaper prices. In India payments are usually not made online and are still settled through the banking channels.

E-procurement is expected to speed up in India Inc. with players like the AV Birla Group having cut costs through online purchases at Hindalco. The Andhra Pradesh government too has floated a tender for setting up a procurement exchange.

This relative nascent Business to Business (B2B) activity is picking up. The total volume of e-procurement was Rs 1500 to 2000 crore in 2001 and is expected to touch Rs 4000 to 5000 crores in 2002.

Companies are being very cautious and are not fully convinced. B2B players like Gate 2 Biz or 01 markets — the e-market place are taking their fee as a percentage of costs saved. The ownership cost of the software and hardware combined is also quite high.

Source : The Economic Times

thus, becomes a potential market for business enterprises, assuming there are no physical or legal barriers to the exchange of goods. *Thirdly*, increased communication at high speed with different parts of the world may encourage business enterprises to develop products preferred by people belonging to different geographical areas. For example, an Indian silk textile manufacturer can get in touch with Japanese and Chinese customers and diversify into making silk garments for them in addition to his existing business of silk sarees. *Fourthly*, e-commerce is also likely to strengthen relationship with customers and business partners, particularly those far away, because of unique opportunities of quick and low-cost mode of communication offered by it. *Fifthly*, cost of a number of business operations may be reduced substantially. For example, it can help reduce advertising costs, expenses incurred in transfer of information, costs involved in carrying the products for display purposes, etc. Further, by providing information on routinely asked questions on the home pages, organisations can save costs by reducing the number of customer service representatives. *Sixthly*, customers have a wider choice. For them, the whole world can potentially become a shop if we can assume that goods amongst all countries can be traded freely. They can look and evaluate the same product in different parts of the world nearly at the same time and do their shopping.

3.6.2 Resources Required for Successful E-Commerce Implementation

E-commerce has significant potential for earning revenues and profits on one hand and cost reduction on the other. Few companies can afford to ignore this large and rapidly growing medium of doing business. However, before embarking upon the programme of conducting business electronically, business firms must have necessary resources. The resources required for the successful e-commerce implementation include the following:

(i) Adequate computer hardware: The business enterprise must procure computers which have necessary speed, memory and nodes sufficient to handle the expected volume of business.

(ii) Technically qualified and responsive workforce: The business enterprise must have well trained workforce which is capable of working with computer networks and internet with ease. They must also be trained to handle the sales inquiries, processing the orders and ensuring prompt delivery. There should be proper coordination among receipt of order, payment and delivery of goods so that mistakes relating to sending goods not ordered, or dispatching goods to wrong destinations may be minimised if not eliminated completely.

(iii) System of receiving payments: The business enterprise need to have a full-proof system of receiving payment for the goods sold. Sufficient information should be made

available so that customers are able to calculate the accurate amount to be paid. Moreover, in case excess amount is received, inbuilt system of refunds must be evolved. The business enterprises must make arrangement with banks, credit card agencies, etc. to facilitate receipts and payments electronically.

(iv) Well-designed website: To communicate effectively with the customers and business partners, the firms must develop a comprehensive website. The information should be as detailed and hyperlinked as possible with suitable supporting pictures, graphs and required technical data. Since this task can be effectively carried out only by experienced and professionally qualified people, the firms must ensure sufficient financial resources to engage their service.

(v) Effective telecommunication system: The presence and growth of e-commerce pre-supposes the existence of an effective telecommunication system. Proper reach of telephone lines, optic fibre cables, and internet technology capable of handling the traffic on the internet are essential pre-requisites. If telephone lines are getting frequently disconnected or if it is difficult to access the internet without making huge investment, e-commerce cannot be successful. It may be stated in this context that unless prompt internet facility becomes available to the common man at low prices, it may remain confined only to the rich or the upper-middle income groups. The problem is referred to as problem of *digital divide.* To make it popular with the low or middle income groups, *digital divide* must be bridged and for this purpose, efforts must be made as a matter of national policy to reduce the cost of hardware as well as price of using internet.

3.6.3 Security and Safety of Business Transactions

While e-commerce offers great business opportunities, its usage is accompanied by several challenges:

(i) Brand-hijacking: Traditionally, companies have used radio and television to create and expand brand identity, a process that takes persistence and a considerable amount of money and time. The internet is a medium in which powerful new brands can be created almost overnight. These new brands can quickly overshadow those that have been well established in other media. For example, in two short years, Amazon.com came from nowhere to become the leading bookseller on the internet, beating out well-known names such as Barnes and Noble.

Amazon.com used a new methodology — word of web (the web equivalent of word of mouth) — to establish the most powerful brand on the internet for buying books. The fundamental nature of the internet fueled this rapid growth by enabling people to talk about the brand through forums, online charts and other means. To pre-empt brand hijacking,

companies must establish their brands in cyberspace as early as possible.

(ii) Hacking: Hacking refers to unauthorised entry into a website. Recently, there has been an alarming increase in the cases of hacking, in which hackers often destroy the data and information which causes huge losses because the flow of business transactions carried out through the website is interrupted. This problem is being addressed by the governments. Special cyber crime cells have been set up. These cells look into crimes committed by hackers and take necessary action against the criminals.

(iii) Viruses: Conducting business electronically involves difficulties that may arise from the viruses, which create numerous problems in carrying out tasks through the computer. Some of the viruses are deadly. They clean up all the information that the computer might be storing. These viruses can enter a system through e-mail or disc drive floppies or certain websites. Viruses invariably hamper the functioning of business. Until the virus is cleaned out things come to a standstill, often causing huge loss of revenue and employee time.

3.7 Outsourcing of Services

The world of business is dynamic and constantly undergoing a change. Over the last decade a new type of business activity within the service sector has come into being the world over. It is called the Business Process Outsourcing (BPO). BPO essentially consists of getting a business task accomplished through an outside agency. For instance, a company may ask its old records or accounts to be maintained by an outside agency. Initially, only a few corporations in the United States attempted to outsource small and relatively low grade jobs like storage of old records. Later, as the confidence grew companies started outsourcing more valuable functions like payroll accounting, and human resource functions such as recruitment of employees, their training and development, etc.

A peculiar feature of BPO is that companies hire out on contract those tasks, which are performed on regular basis. It is a marked departure from the earlier practice of a business enterprise carrying out all its business operations and tasks on its own. Earlier, firms used to hire outside agencies only for such tasks and operations, which used to come up occasionally. For example, companies would hire the services of a management consultant for getting their employees trained or a new software developed to meet the specific needs of a company. Or the companies would hire the services of an advertising firm to design its advertisement and carry out the advertising campaign. Routine and regular tasks, like after sales service, managing accounts receivables, maintaining books of accounts, etc. were carried out by business enterprises own staff. BPO consists of hiring out these routine and regular tasks. The idea of business process

outsourcing has its origin in the Core Competency Theory propounded by famous management consultant C.K. Prahlad. The basic contention of the theory is that a business enterprise should identify what are its core competencies and focus only on them. It should get out of everything else so that all energies could be channeled into areas which represent its strength. The theory had profound and enduring effect on the operations of many big corporations. Companies realised that they could outsource several functions to specialist outside firms that would free them so as to concentrate on matters more crucial to their business like manufacturing or product management or marketing.

Advantages of Business Process Outsourcing

(i) As stated above BPO provides an opportunity to business to concentrate on areas in which it has core competency.

(ii) It has been observed that the

Foreign Companies, Domestic Execution

Overseas clients are seeking to outsource their business processes and looking at India for execution. A recent survey conducted by Merrill Lynch showed that a number of companies in the US are either planning to sustain or increase their level of outsourcing from India in the next two years. US company, General Electric was among the first to demonstrate India's potential as a base for remote service facilities by setting up the country's first international centre.

In India, the business process outsourcing charge has been led by multinationals with strong Indian operations such as Citi Bank, Amex, Standard Chartered Grindlays, GE, who started moving their back office operations into India in the past three to four years. The Indian arm of American Express handles the global processing of it's cards business and travel-related accounting and financial transactions for the Japan/Pacific/Asia/Australia region. The Amex FRC (Financial Resource Centre) East, the Indian Centre in New Delhi is aligned with it's functions and organisational structure.

Multinational companies based in the US and Europe by outsourcing their operations in India have effected large cost-saving. The savings in costs are largely due to the difference in the salary structure.

Outsourcing offers a distinct advantage especially during an economic slowdown, when margins are under pressure and companies are cutting down costs. It is one of the best ways to reduce operating costs and more companies are expected to look at this as an option.

India's high quality workforce and their capacity to handle increasingly complex projects, it's 24 million English speaking graduates, an advantageous time-zone location and cost benefits make it a first choice for overseas clients to outsource.

Source : Business India

outsourcing agencies are specialists in their area. They perform the same job at a fraction of what it costs the business unit to run an inhouse department and hence, represents big savings.

(iii) The outsourcing service provider very often acts as a consultant for that particular function and advises its clients, the hiring enterprise, on better ways of managing that function.

(iv) It helps avoid the labour problem because outsourcing reduces the need to employ more employees.

Types of Outsourced Services

Business firms are increasingly opting for outsourcing following services:

(i) Financial Services;
(ii) Advertising Services;
(iii) Courier Services;
(iv) Customer Support Services.

(i) Financial services: Business firms often need services of specialists for managing various aspect of business finance. For example, when a company needs to raise finance by way of issue of shares and debentures, or has to raise loans from financial institutions like banks, a number of legal and procedural formalities have to be carried out. These formalities are often cumbersome and therefore require specialised knowledge and expertise. Likewise, when an individual or a firm wishes to buy another firm, or when two firms agree to merge to form another firm, their assets and liabilities have to be properly valued. Such valuation cannot be routinely done and requires specialised knowledge. Besides, often firms do not want surplus cash to remain idle. They want to invest it in securities or deposits where liquidity and safety of funds and assured returns are high. All these activities are highly specialised in nature. Business firms outsource these activities. There are firms which specialise in providing such services. A newly emerging trend is that companies give away even the task of maintaining their accounts also to such specialist firms. There are firms which offer finance/accounting services (expense processing, balance sheet reconciliation) transaction processing for cheques, claims processing, and payroll administration services. These providers of financial services maintain a pool of personnel who have expert knowledge relating to legal, financial and managerial aspects of business, finance. Companies hire the services of these specialist firms to take advantage of their expertise.

(ii) Advertising services: Advertising is one area which is traditionally, the most frequently outsourced service. Business firms hand over the task of designing and carrying out the advertisement campaigns to advertising firms. These firms design the advertisement copy, select the media of advertising and arrange time and space for advertising. Also, they make audiovisual films for display in various media like television, cinema, radio, internet, etc. If the business firm were to carry out this

Financial Services

There are many Indian firms which are providing exclusive financial services to their clients in the United States. Exl Service is a firm owned by Conseco Inc., an Indianapolis based insurance and finance company. It is qualified to take up on behalf of a US insurance client, each of the jobs from the time a customer decides to take a policy, until the document is actually issued to the customer.

Spectramind undertakes non core but essential activities for clients in the United States and Europe. It focuses on only added-value processes such as financial services, insurance, IT, and telecommunications. Spectramind has also gone in for venture funding. It attracted 14 million dollars in venture funding from software giant Wipro Ltd. and venture fund investor Chryslar Capital.

There is a distinct movement towards other added-value business process outsourcing which includes financing/accounting services, transaction processing for cheques, claims processing, etc. This requires fairly sophisticated and detailed knowledge of the industry segment, apart from a high degree of intellectual input.

Source : Business India

E-Funds Specialises in Financial Services

E-funds processes 175000 to 200000 cheque book requests per month for a cheque book Printer Company in the US. The company or any bank in the US scans it and the image is stored on the server. Back here in India, an agent accesses the image and processes the request. This involves ensuring accuracy in name, address, spelling font and meeting a specific design request of the customer. This input is transmitted back to the US for printing and delivery. This process has reduced the number of errors in data processing by 90 per cent. E-funds also does revenue accounting. It has three aspects to it: account payable, receivable and general account. The office generates reports for officials back in the US to help take strategic decisions. Financial reporting is done on the basis of GAAP (Generally, Accepted Accounting Principles). Commerce graduates and post-graduates are employed and given training to understand them.

Source : Business World

task on its own, it would have to employ copywriter, filmmaker, cameramen and others, since, an advertisement copy once made is used for quite a long time, sometimes extending over several years. The services of these personnel, employed for the purpose of advertisement work, would not be required until advertisement copy or campaign needs to be revised. During this period, they would remain without work. Therefore, companies do not

employ them directly. Instead, business firms hand over this task to advertising firms.

(iii) Courier services: Over the past one and half decades, a new form of service has come into being, known as courier service. Essentially, it is the postal service provided by private firms for carrying mails and parcels including books, light goods and samples of products to various destinations. Business firms often require speedy transfer of documents, samples etc. from one place to another. For this purpose, there is always an option of sending these through one of the employees of the firm. But it would prove to be very costly if such transfers were too many distant or both. The firms therefore outsource this function to the providers of courier services. Now-a-days such services are available

Domestic Courier Industry Records a 15 Per Cent Annual Growth

The Indian courier and express delivery industry has become a Rs 5000 crore plus industry. If the last few years of 12-15 per cent growth is any pointer, the industry is on its way to become one of the largest service businesses in the country.

The explosion of e-mail doesn't seem to have had much of an impact on the industry as Indians still believe in hard copy. The decrease in personal mail on account of e-mail, has been more than compensated by a surge in direct mailers and marketing literature from marketing companies and the growing business of bank statements and utility bills.

In the last fiscal year even as the government postal system ran a deficit of Rs 1462 crore from Rs 1596 crore in 1999, private courier companies had a spurt in business activity with 20 per cent growth in parcel volumes. There existed a latent demand for a delivery service that was fast and reliable and the courier service met this need and created a business opportunity.

Courier Service: Postal Board to be Licensor

The postal department is set to bring private courier operators under government regulation. The postal board would be made the licensing authority for private courier operators. Provisions are also made for punishing unauthorised persons from carrying/delivering mail.

The obligations on private couriers would include the non-transferability of the registration without central government permission. A courier operator would also be forbidden from accepting and delivering forbidden substances, failing which they would attract suspension/revocation of licence. The registration of courier operators would not only bring standardisation in services offered, but also earn the postal department some fees.

Source : The Economic Times

on desk-to-desk basis, that is, the courier firm picks up the material to be transferred from the sender and delivers it to the addressee. A large number of courier service firms have come into being over the last one decade or so particularly in cities and towns and are doing booming business.

(iv) Customer support services: Nearly all durable goods, whether used by industrial enterprises or final consumers, require customer support services which are also known as after-sales services. For instance, for the proper maintenance of various products and machinery, regular servicing is required. In case, these develop any defect and become out of order, these need to be attended to promptly. Traditionally, large corporations had their own customer support services department. These were manned by the personnel having necessary expertise to handle diverse complaints from their customers. Prompt, effective and polite attention to customer complaints has been recognised as the corner stone of creating goodwill and enhanced image regarding the product as well as the company. Therefore, these departments occupied a place of considerable significance. Now-a-days, companies are fast moving away from the tradition of maintaining their own service departments. Instead, the task performed by these departments are contracted out to other firms. The customer support services are provided by these outside agencies. On their part these agencies carry out the customer support services for various companies and brands. The providers of customer support services have to ensure complete customer satisfaction on behalf of the company engaging their services. The companies demand highest level of performance from these providers of customer services because image of the company greatly depends on the quality of services. Any flaw in this regard often leads to cancellation of the contract by the companies engaging customer support service agency.

SUMMARY

Classification of business activities: On the basis of size, structure of business may be said to consist of small scale and large scale business units. On the basis of ownership, business structure may be viewed as consisting of public sector units and private sector units.

Private business firms are organised in several forms. They include sole proprietorship, partnership, joint Hindu family, joint stock company, and co-operative society. On the basis of function, we may study business activities as consisting of industry and commerce.

Industry and its types: It refers to economic activities which are connected with

conversion of resources into useful goods. The term industry is used for activities in which mechanical appliances and technical skills are involved. Industries may be divided into three broad categories: primary industries; secondary industries; and tertiary industries. Primary industries may be further subdivided as follows: extractive industries; and genetic industries. Secondary industries as: manufacturing industries; and construction industries. Tertiary industries provide service facilities.

Commerce: This includes two types of activities first, all those business activities, which are undertaken for the sale or exchange of goods. These are termed as trade. Second, various services that facilitate trade. These are called services or auxiliaries to trade and include transport; banking; insurance; communication; advertisement; packaging; and warehousing. Commerce is thus, defined as activities involving the removal of hindrances in the process of exchange.

Trade and its types: Trade is an integral part of commerce. It refers to sale, transfer or exchange of goods. It helps goods produced being made available to ultimate consumers.

Internal trade: It is also known as domestic trade or home trade or inland trade. It consists of sale, transfer or exchange of goods within a country.

There are two types of internal trade viz. wholesale trade, retail trade.

External trade: It is also known as foreign trade, consists of trade among different countries. It involves import and export of goods.

Auxiliaries to trade: Activities which are meant for assisting business are known as auxiliaries to business. These activities are generally, referred to as services also because these activities are in the nature of facilitating the activities relating to industry and trade. Transport; banking; insurance; warehousing; and advertising are regarded as auxiliaries to trade, i.e. activities playing a supportive role. In fact, these activities not only support trade but also industry and hence, the entire business activity.

E-commerce: One of the major causes of change in the life of human beings has been technology. A major technological break through in recent years has been computer application. Electronic commerce Thus, refers to all forms of business transactions which are based on electronic processing and transmission of data including text, sound and visual images. E-commerce can take place within or among three groups of economic actors namely business, government and individuals.

Opportunities and benefits of e-commerce: It offers tremendous opportunities for business enterprises to expand their sales and strengthen business to business relationships. Increasingly larger numbers of people are making use of internet. According to an estimate, millions of people around the world exchange information or do deals through this medium.

Resources required for successful e-commerce implementation: E-commerce has significant potential for earning revenues and profits on one

hand and cost reduction on the other. The resources required are adequate computer hardware, technically qualified and responsive workforce; system of receiving payments; well-designed website; effective telecommunication system.

Security and safety of business transactions: While E-commerce offers great business opportunities, its usage is accompanied by several challenges: brand-hijacking; hacking; viruses.

Outsourcing of services: Over the last decade a new type of business activity within the service sector has come into being the world over. It is called the Business Process Outsourcing (BPO). This essentially consists of getting a business task accomplished through an outside agency. A peculiar feature of BPO is that companies hire out on contract those tasks, which are performed on regular basis. The idea of business process outsourcing has its origin in the Core Competency Theory propounded by famous management consultant C.K. Prahlad. The basic contention of the theory is that a business enterprise should identify what are its core competencies and focus only on them.

Types of outsourcing services: Business firms are increasingly opting for outsourcing following services: financial services; advertising services; courier services; customer support services.

EXERCISES

Short Answer Type Questions

1. What is meant by structure of business?
2. Explain the different activities classified under commerce.
3. How is banking and finance important to trade?
4. How has technology changed business?
5. How can you ensure safety of transactions while using E-commerce?
6. Why are businesses increasingly outsourcing services?

Long Answer Type Questions

1. Explain the different types of industries.
2. Discuss the functions performed by commerce.
3. What are the opportunities and benefits offered by E-commerce?
4. What are the resources required for implementation of E-commerce?
5. Explain the different types of outsourced services.

Project Work

1. Find out from any firm providing courier services the kind of difficulties they face, the clients they have, their success rate etc.
2. Make a list of firms providing financial services. Find out the types of financial services they provide.

CHAPTER 4

Service Sector and Business

LEARNING OBJECTIVES

After studying this chapter, you should be able to :

- identify the different types of financial services;
- explain the functions of commercial banks;
- appreciate the significance of insurance;
- describe how business risks can be covered;
- identify the different types of warehouses;
- analyse the recent trends in communication.

4.1 Introduction

In the previous chapter we have discussed the structure and scope of business and also outlined the importance of e-commerce and outsourcing of services. In the recent past, role of service sector in the Indian economy is growing faster than industry and agriculture. This chapter is devoted to the explanation of types, functions and principles of banking, insurance, communication and warehousing sectors of the Indian economy.

The era of economic liberalisation has ushered in a rapid change in the service industry in recent years. As a result, one can witness today the flooding of innovative services in the business world, not only around the country, but also, around the world. The current economic scenario is clearly characterised by a radical reorganisation of the service industry, which has branched out into many fields (travel, transportation, advertising, equities, telecommunications, consultancies, janitorial services, engineering, tax and accounting, and so on). A variety of services is available to meet both the dynamic changes in the economy and the diverse requirements of the investors. Thus, the significance of services is gaining momentum and no wonder; it has become a major thrust area in the field of business.

4.2 Banking, Finance and Insurance

Business enterprises in India are closely linked with the financial markets and institutions. The flow of savings provides funds for investment in industry, trade and service organisations. The banking system ensures this smooth flow of money to business. Thus, the financial intermediaries and financial instruments and securities facilitate transfer of funds and are an integral part of the business system.

4.2.1 Nature and Types of Financial Services

In general, all types of activities, which are of financial nature, could be brought under the term *financial services*. The financial services in a broad sense means mobilising and allocating savings. Thus, it includes all activities involved in the transformation of savings into investment. The financial services can also be called financial intermediation. Financial intermediation is a process by which funds are mobilised from a large number of savers and made available to all those who are in need of it and particularly to corporate enterprises. Thus, financial services sector is a key area and is very vital for industrial development. A well-developed financial services sector is absolutely necessary to (a) mobilise savings; (b) allocate them to various investible channels; and (c) promote industrial development in a country.

Types of Financial Services

Financial services cover a wide range of

activities. The traditional activities are banking and insurance. These are discussed in detail in the following paragraphs. Besides, the above traditional services, many new financial services such as merchant banking, loan syndication, leasing, mutual funds, factoring, venture capital, etc., have emerged in the recent past. These are playing an important role in the smooth functioning of business. Some of these are discussed below:

(i) Merchant banking: It refers to the services of an intermediary in the stock market who provides services for issue management, underwriting, corporate restructuring, etc. Merchant banks, also called *investment banks* are most significant institutions in the financial markets of developed countries. They help in promoting and sustaining capital markets and they provide a variety of financial services to the corporate sector. The scope of merchant banking activities has been expanding in India over the years. The recent changes in the Indian economy and financial markets are expected to provide a further impetus to the growth of merchant banking. Merchant bankers benefit corporate clients in a number of ways.

They look into various legal and procedural complications involved in the securities issues and raising of loans. They also provide professionally competent advice in matters of investment, capital restructuring, mergers and acquisitions, valuation, etc. They also help in cultivating an investment climate as well as financial innovativeness in individual investors and corporate clients.

A large number of nationalised banks have set up divisions for offering merchant banking services. Issue management is their main activity.

(ii) Leasing: It is a legal agreement that obligates the user of an asset to make payments by way of a lease rent to the owner of the asset in exchange for using it. The owner of the asset is called the *lessor* and the user is called the *lessee*. The lessee pays the rental to the lessor as regular fixed payments over a period of time at the beginning or at the end of a month, quarter, half-year or year. Although generally, fixed, the amount and timing of payment of lease rentals can be adjusted to the lessee's profits or cash flows. At the end of the lease contract, the asset reverts to the lessor who is the legal owner of the asset.

A lessee can be an individual or firm interested in the use of an asset without actually owning it. Lessors may be equipment manufacturers or leasing companies who bring together the manufacturers and the users. In India, independent leasing companies form the major group in the leasing industry.

There are many benefits derived from lease financing. The primary consideration is the cost of lease vs the cost of buying. The cost of leasing equipment turns out to be much less expensive than buying equipment outright. Then, there is convenience and flexibility. Financial leases are less restrictive and can be negotiated faster.

Leasing companies play an important role as financial intermediaries. They encourage investment by making funds available in a less cumbersome and speedy manner. Lease financing is a real gap-filler for non-priority and small scale sectors. Thus, leasing is another financial instrument which can help some segments of the manufacturing industry to grow.

(iii) Mutual funds: It refers to an organisation or a company that pools funds from individuals and other organisations to invest in a portfolio of stocks, bonds and short term securities. The main feature of a mutual fund is that it makes diversification of portfolio a possibility for small investors who otherwise may not be able to do so.

Mutual funds are financial intermediaries, facilitating the process of savings and investment. They mobilise savings from investors by selling their units or shares. The savings collected are invested in the shares of a large number of companies. Thus, they provide investors, particularly the small investors, opportunities to indirectly own equity shares.

The first mutual fund started in India in 1964 was the Unit Trust of India (UTI). Later on, in 1987 the State Bank of India and Canara Bank set up mutual funds. Now, many banks have set up their mutual funds. There are many private sector mutual funds and foreign mutual funds which have also been established in the country.

(iv) Factoring: It refers to the practice of raising funds by selling a firm's accounts receivable to another company or agency. Credit management is a specialised activity and involves a lot of time and effort of a company. Therefore, collection of receivables poses a problem. Banks also follow the policy of financing receivables for a limited period only. A company may assign its credit management and collection to a specialist organisation called *factoring organisations.*

Factoring is both a financial technique and a management service. It is a method of converting a book debt into cash, by selling book debts (receivables) to a company that specialises in this collection and administration. This company or individual which specialises in these activities is called a factor. Factors provide financial assistance to the client by extending advance cash against book debts. Factoring thus, involves an outright purchase of debts, allowing full credit protection against any bad debts and providing financial accommodation against the firm's book debts. This is in return of a factoring commission and interest on advance given.

(v) Venture capital: This is generally, considered as high risk capital. Venture capital is mainly initial capital provided for new ventures in high risk areas where the conventional sources of finance are not available. In practice, this kind of capital helps budding entrepreneurs having skills and business sense to

realise their dreams. Being a new concept it does not meet the rigid requirements of financial institutions and so new means of financing are needed. In such cases, venture capital provides the needed financial resources in the form of equity capital to implement the project. Usually, new projects of high technology are taken up. The equity finance is provided in return for part ownership of the borrowing firm. Venture capitalists not only provide finance but also assist in the management of the enterprise to ensure smooth implementation.

4.2.2 Banks and Their Functions

Availability of finance for the uninterrupted flow of goods and services from producers to manufacturers and manufacturers to the wholesalers, retailers and to the ultimate users or consumers is the most essential aspect of business. By making available money through various devices, banks help in meeting these financial requirements.

Definition

The term *bank* is derived from the word *banko* or *banck*, which means a bench or table on which European money lenders and money changers in the past used to exhibit coins of different countries in big heaps for the purpose of changing and lending money. A bank is now regarded as an institution, which attracts money on deposit for the purpose of being lent to industry or trade. Banker is not merely a money-lender. He lends what he has borrowed from others. Hence, a banking institution is that which accepts money on deposit, repayable on demand and which earns a margin of profit by lending money.

A bank being a buyer and seller of money stimulates business activity by mobilising savings of the people and making the funds available to finance capital and revenue expenditure of business undertakings. It may also assist the consumers to finance their purchase of costly goods and services. Taken in a general sense, banks are business enterprises that deal in finances, financial instruments and provide financial services for a price known as interest, discount, commission, etc. According to the Indian Banking Regulation Act 1949, banking means *accepting deposits of money from the public for the purpose of lending or investment.* These deposits may be payable on demand or otherwise and may be withdrawn by cheque, draft, order or otherwise.

Features of Commercial Banks

By its very definition a bank is an institutional arrangement for the fuller utilisation of the surplus funds of society by making them available to those sections of society, which need them. In this sense, it is the provider of the circulatory system which is the very life blood of our modern economy. In the whole working of the bank it is clear that it holds and lends not the money but the right to use others money at a

price, called *interest*. From this fact, following features of a bank come out clearly.

(i) Role of an intermediary: Bank is an intermediary (like a middleman) between those who have surplus funds — the depositors of funds — and those who need these funds — the borrowers of money.

(ii) Mobilises capital: It accepts deposits from all sections of society. The amount so accumulated is made available to trade, industry and commerce. Thus, it directly leads to mobilisation of financial resources of the society lying scattered in small amounts.

(iii) Plays the role of creditor and debtor: A bank plays the roles of creditor and debtor at the same time. It is indebted to all the depositors whose money, for the time being it is using, to advance loans, etc., to its needy clients. At the same time, it is a creditor to those whom it has granted loans and advances.

(iv) Creator of money: Banks create money when they grant overdraft and credit facilities to account holders.

(v) Custodial services: By taking care of the liquid asset (money) as well as costly items such as gold, silver and other precious metals, ornaments of housewives, important documents, etc., in its safe deposit (lockers) the bank acts as a custodian for such articles of its clients.

(vi) Instrument of innovation: With the money borrowed from banks many young enterprising technical and non-technical persons have been able

How Banks Create Money

Banks stay in business by earning more on interest from loans than they pay out in the form of interest on deposits; they can increase their earnings by *creating* money. When customer A deposits Rs100 the bank must keep some in reserve but can lend, say, Rs 80 to customer B (and earn interest on that loan). If customer B deposits the borrowed Rs 80 in the same bank, the bank can lend 80 per cent of that amount to borrower C. The initial Rs 100 deposit, therefore, creates a much larger pool of funds from which customer loans may be made.

Deposits	*Reserve*	*Lend*	*Borrower*	*Total Supply*
100.00	20.00	80.00	B	180.00
80.00	16.00	64.00	C	244.00
64.00	12.80	51.20	D	295.20
51.20	10.24	40.96	E	336.16
40.96	8.19	32.77	F	368.93
32.77	6.55	26.22	G	395.15
26.22	5.24	20.98	H	416.13

to introduce new ideas, new styles, new design and new products. Thus, banks are proving to be an instrument of innovation.

(vii) Agency services: Bank acts as an agent to their clients. The money held in deposit or other accounts or the property kept in the lockers is the property of the client. Bank is only its custodian on behalf of the owner of the property. Even the sale and purchase of shares or other securities, transfer of money, etc., are done on behalf of and as per the instructions of the clients

Types of Commercial Banks

The commercial banks have been classified on the basis of their ownership. Public sector banks are owned and controlled by the government. In private sector banks, private investment is made by the public, and in case of foreign banks by the foreign investors, which promote the banks.

(i) Public sector banks: Public sector banks are those in which the government has a major stake. This stake of the government makes these banks emphasise on social objectives than on profitability *per se*. The public sector banks have dominated the Indian banking scene for over three decades since nationalisation of fourteen major banks in 1969. The major players are the State Bank of India, the Canara Bank, and the Corporation Bank.

(ii) Private sector banks: These are owned, managed and controlled by private promoters. They are free to formulate policies about their activities as per market forces. Private sector banks were allowed to compete with the foreign banks on a near equal footing since public sector banks were in bad shape and burdened with fulfilling social objectives. Many of these private banks were promoted by financial institutions like IDBI, ICICI, HDFC, etc.

(iii) Foreign banks: Most of these banks in India are the subsidiaries of foreign banks. These are owned and managed by foreign promoters. These banks have realised the potentially big market in the retail banking sector. After the liberalisation process started, a number of foreign banks have proliferated in India, attracted by the large Indian market. The major foreign banks in India are Citibank, Bank of America, Standard Chartered Bank, American Express and Hongkong Bank.

Functions of Commercial Banks

Banks perform many functions which vary according to the types of banks. Some of these functions are the basic or primary functions of a bank. Others are agency or general utility services in nature. In this section we shall discuss only the more important functions of commercial banks. These are briefly discussed below:

(i) Collection of deposits: It is one of the primary functions of a bank. Deposits are the basis of the loan operations of these banks. They are both borrowers and lenders of money.

As borrowers they pay interest on the balance of deposits and undertake to repay them as and when due or on demand. Depositors can withdraw their money from their accounts in the bank either in the form of cash or through cheques drawn on the deposit. The bank is indebted to the deposit-holders to the extent of the credit balances.

(ii) **Granting of loans and advances:** Banks usually advance credit to businessmen by way of overdraft, cash credits, loans and discounting of bills. Granting of credit in different forms is one of the basic functions of banks. The funds lent out by banks contribute a great deal to the development of trade, industry, transport and other business activities. Besides, the earnings and profits of the bank depend mostly on interest they collect on the money lent by them.

(iii) **Collection of cheques and bills:** Banks render a very important service to their customers by collecting their cheques drawn on other banks. They send such cheques to the concerned banks for collection and credit their proceeds to the *accounts* of their customers. In case of local cheques, collection is made generally, free. In case of outstation cheques the banks charge a commission for collecting them plus postage. This facility is most important in case of crossed cheques received by the customers. An account holder can pay in the crossed cheques to her/his bank, which arranges for their collection and subsequently credits the same to her/his account. Banks also collect bills of exchange from the acceptor on due dates on behalf of their customers and credit the proceeds to their accounts.

(iv) **Personal services:** Banks undertake to pay insurance premium, collect dividend, premium, or interest on investments on behalf of their customers. Thus, customers are saved from the task of remembering the due dates of pension, insurance premium or of dividend, or interest accrued on their investments. Under standing instructions of the customers banks pay the premium or collect dividends, etc., in time and debit or credit the customers' accounts as the case may be with the amount paid or collected respectively.

(v) **Buying and selling of shares, debentures, etc.:** Banks, on instructions from their customers undertake to buy or sell shares, debentures, governments securities, bonds, etc. and debit or credit their accounts as the case may be with the purchase price or sale proceeds respectively.

(vi) **Custodial service:** Commercial banks accept precious articles like gold, silver, valuable papers like shares, bonds, insurance policies, important deeds of contracts, etc. for safe custody. They maintain safe deposit vaults for storing these valuables. A small rental charge is levied for this service. This service is indeed a good safeguard against loss of valuable articles due to theft, or misplacement.

(vii) Provision of remittance facilities: Banks provide remittance facilities also for transfer of funds from one place to another. A person intending to send money to another person at a distant place can purchase a demand draft from the bank. The bank issues a draft for the amount on its own branches at other places or other banks at those places. The remitter sends the draft to the payee by post. The payee can present the draft on the drawee bank at his place and collect the amount. The bank charges commission for issuing the drafts. Remittance of money through drafts is cheaper, more convenient and safer.

(viii) Issue of letters of credit: Banks issue letters of credit, which are useful to traders and businesspersons. Letters of credit are most useful in import trade. Issued by the importer's bank, the letter of credit serves the purpose of assuring the exporter about importer's credit-worthiness.

(ix) Issue of traveller's cheques: Banks issue traveller's cheques of different denominations. The tourists have to put their signatures at the time of taking the cheques. They can present these cheques at different places with specified bankers for encashment. While claiming payment, they have to sign again. The comparison of original and subsequent signatures enables different banks to identify the holder.

(x) Provision of credit information: Banks are frequently requested to provide information related to the credit-worthiness of their customers. The firms or individuals intending to transact their purchases on credit basis are asked by the sellers to furnish the name of a bank for reference to ascertain their credit standing.

(xi) Electronic banking: With the aid of computerised equipment banks are now in a position to offer new services. It takes many forms:

(a) **Electronic funds transfer system (EFTs):** This system offers convenience for customers and cost saving for financial institutions. This enables employers to transfer wages directly from the company bank account to employee's accounts. This service saves both employer and employee from inconvenience of handling large amounts of cash.

(b) **Automated teller machines (ATMs):** It is a freestanding self-service terminal that can do about 60 per cent of a teller's job 24 hours a day at less than half the cost of a human teller. To use an ATM, you insert a plastic card into the terminal and then enter an identification code. The machine responds by giving cash, taking deposits, and handling other simple banking transactions.

(c) **Debit card:** A more complex variation of electronic banking involves the use of point-of-sale (POS) terminals located at merchant's checkout counters and tied electronically to a bank computer. When a store customer presents a debit card,

the point-of-sale terminal automatically transfers the money for the purchase from the customer's account to the store's account. Yet another variation enables a person to pay bills automatically by using a personal computer, which is linked by telephone to the bank computer. When the customer types in the required information, the bank computer transfers money from the customer's account to the biller's account.

(d) **Credit card:** Credit card is like opening a bank account (without making any deposits) for daily payments by the cardholders. It enables the cardholders to have overdraft facilities of an amount depending upon the credit worthiness of the party. Credit card is a substitute for cash that can be used by selected customers of banks issuing the cards for payments for goods and services. These plastic cards have the photo identity and signature embossed on the cards. It also includes the issuing bank's name and validity period of the card.

4.2.3 Insurance

In the dictionary of business and finance, insurance is stated to mean *a form of contract or agreement under which one party agrees in return for a consideration to pay an agreed amount of money to another party to make good a loss, damage, or injury to something of value in which the insured has a pecuniary interest as a result of some uncertain event.* It is a device by which the loss likely to be caused by an uncertain event is spread over a number of persons who are exposed to it and who propose to insure themselves against such an event. Thus, we may define insurance as the provision, which a prudent man makes against happenings by chance, or inevitable contingencies, loss or misfortune.

This agreement or contract is put in writing and is known as policy. The person whose risk is insured is called *insured* or *assured* and the person or the firm which insures the risk of loss is known as *insurer, assurer* or *underwriter*. The consideration in return for which the insurer agrees to make good the loss is known as premium. This premium may be paid by the insured monthly, quarterly, half-yearly or annually.

Why is Insurance Needed?

Life is full of uncertainties. Attempts have been made in the past and are being made in our days to minimise the effect of as many uncertainties of life as possible. But, we are not free from the anxieties as to what may happen to our life or property next moment. Buildings may get wholly or partially destroyed due to fire, storms, cyclones, etc. Goods and other property may be lost or destroyed due to theft, robbery, fire, flood and such other happenings beyond human control. Both life and property are exposed to risk of accidents. Death or serious injury caused by train or air accident or

shipwreck, loss of goods and property in transit are common incidents. Everyone is exposed to one type of risk or the other. But it is impossible to say in advance as to on whose shoulder the heavy burden of such a loss is going to fall. It means that no one can be certain of smooth sailing in private life or business. After all the precautions taken to avoid uncertainties of life and business, there are many possibilities of unfavourable happening. It is to minimise the impact of such uncertainties that there is a need of insurance.

It is difficult for an individual or even a large business enterprise to invest millions of rupees in the huge factory buildings and equipment or giant ships unless the arrangement for covering the risks is possible. This arrangement is made by insurance.

Fundamental Principle of Insurance

The basic principle of insurance is to be seen in the fact that the insured (an individual or a business concern) chooses to spend a definitely known sum in place of a possible huge amount involved in an indefinite future loss. Thus, insurance, in essence, is the substitution of a small periodic payment (premium) for a risk of large possible loss. The loss of risk still remains, but the loss, when it occurs, is spread over a large number of policyholders exposed to the same risk. The premium paid by them are pooled, out of which the loss sustained by any policyholder is compensated. Thus, in effect, risks are shared with others.

From the analysis of past events the insurer (an insurance company or an underwriter) knows the probable losses to be caused by each type of risk covered by insurance. The amount of premium payable by each policyholder is so fixed that the amount collected by way of premium from all the policyholders should be enough to pay for the losses actually suffered by the policyholder or policyholders and to cover the expenses of the insurance company and leave a reasonable margin of profit. The insurance company does not know which of the policyholders will suffer a loss. But risks of all the policyholders are combined, premiums paid by them are pooled and each policyholder is protected.

As stated earlier, all risks cannot be insured. The insurability of any risk depends upon many considerations. More important of them are given below:

(i) The loss must be foreseeable and subject to estimation. It must be predictable and possible to calculate mathematically.

(ii) The risk covered must be spread over a large number of policyholders in order to average out the risk. Probable loss is estimated on the basis of the *law of averages*. The larger the number of those exposed to a particular risk more reliably an average can be worked out.

(iii) The premium should be within the reach of those in need of the protection offered by insurance.

(iv) Policy holders should be dispersed over a wide geographical area. The risk must be so dispersed over a wide geographical area that the happening of a single event in a small region may not draw heavily upon the funds of the insurer.

Insurance and Assurance

The two terms *insurance* and *assurance* are often used in the discussion of insurance business to mean one and the same thing. But the terms are not synonymous. Assurance refers to a contract under which the sum assured is bound to be paid sooner or later. A contract of insurance is a contract for compensation for damage or loss as in the case of fire or marine insurance. In these types of insurance the insured must suffer a pecuniary loss before he can claim compensation from the insurer. If there is no such loss, the claim does not arise. Contrary to this, a contract of assurance is an out and out contract, e.g., a contract of life insurance. In such a contract the payment of the sum of money assured is bound to be made either on the maturity of the policy or the death of the assured.

Thus, the term, *insurance* is used when the risk is uncertain and it may or may not happen. For example, a warehouse may catch fire or may not, or ship may sink in the high seas or may reach the port of her destination safely. In all these cases the policy is not sure to become a claim. But in the case of an assurance, the policy is bound to become a claim in the stipulated manner. For example, a person is bound to die sooner or later, or is bound to attain a particular age. The amount assured by a life policy must be paid on the attainment of a particular age specified in the contract or after death, whichever is earlier.

In other words, the term insurance is used where compensation is guaranteed to be paid only on the happening of an event, which may or may not happen. The word assurance is meant for the contract, which assures the payment of a certain sum on the happening of an event, which is certain.

However, the distinction between the two terms mentioned above is of very little practical importance because both the terms are very widely used to mean one and the same thing. For example, our life insurance business is referred to as life insurance instead of life assurance. Even the name of the Life Insurance Corporation of India seems to have ignored the refined meaning of the two terms.

General Principles Governing Insurance

(i) Utmost good faith: In case of an ordinary business contract the principle of caveat emptor or let the buyer beware is applied. It means that it is the duty of the buyer to satisfy himself about the quality, quantity and soundness of the goods or property to be purchased before she/he enters into contract with the seller. The seller is not under any obligation to provide any information not asked for. But a contract of insurance is a contract

uberrimae fidei, that is to say, a contract founded on utmost good faith. It is a condition of every insurance contract that both the parties, the insured and the insurer, should display utmost good faith towards each other in regard to the contract. This duty continues till the time the negotiations for the contract are completed and is equally applicable to both the parties. At the time of negotiation the person who wants to insure is called proposer. The principle of utmost good faith makes it binding on her/him (the proposer) to tell the insurer all the material facts that she/he knows or ought to know about the subject matter of the proposed insurance. Each fact which is likely to influence the mind of prudent insurers in deciding whether to accept the proposal (of insurance) or in fixing the rate of premium is material for this purpose. Similarly, the insurer is bound to exercise the same good faith in disclosing the scope of the insurance, which she/he is prepared to grant. Failure to make disclosure of material facts by the insured makes the contract of insurance voidable at the discretion of the insurers.

(ii) Insurable interest: Another principle of insurance contract is that the insured must have an insurable interest in the subject matter of insurance. Insurable interest means some pecuniary interest in the subject matter of insurance contract. Without such interest the contract will be regarded as gambling and, therefore, void. Existence of the insurable interest is the essence of insurance, which makes it fundamentally different from gambling, or a wager because insurance can be granted only when there exists an insurable interest. It must be lawful and clear that the insured has an interest in the preservation of the thing or life insured, so that he will suffer financially on the happening of the event against which she/he has insured.

In the insurance of property (fire, marine, etc.) insurable interest of the insured is essentially a pecuniary interest. It means that the loss caused to the insured by the happening of the risk must be capable of estimation in terms of money. Further, in such contracts, the insurable interest in the subject matter of the insurance must exist at the time of the happening of the event. When the insured event takes place, the actual loss, and not the amount for which the event is insured, is paid to the insured.

It must be noted that to have an insurable interest in the property insured, it is not necessary to be the owner of the property. For example, a person who had advanced money on the security of a house (the mortgagee) has an insurable interest in that house. In case of a house on lease both lessor and the lessee have such an interest. Similarly, a trustee holding property on behalf of another has an insurable interest in that property.

(iii) Indemnity: Another important principle in case of insurance of property like fire and marine insurance is that of indemnity. A contract of fire

Insurable and Non-Insurable Risks

Insurance companies consider some pure risks insurable. They usually view speculative risks as non-insurable. Some pure risks such as flood and strike are also considered non-insurable.

Insurable

Property risk : uncertainty surrounding the occurrence of loss from perils that cause:
- direct loss of property;
- indirect loss of property.

Personal risks : Uncertainty surrounding the occurrence of loss due to:
- premature death;
- physical disability;
- old age.

Legal liability risk : Uncertainty surrounding occurrence of loss arising out of:
- use of automobiles;
- occupancy of buildings;
- employment;
- manufacture of products;
- professional misconduct.

Non-Insurable

Market risks : Factors that may result in loss of property or income, such as:
- price changes, seasonal or cyclical;
- consumer indifference;
- style changes;
- competition offered by a better product.

Political risks : Uncertainty surrounding the occurrence of:
- overthrow of the government or war;
- restrictions imposed on free trade;
- unreasonable or punitive taxation;
- restrictions on free exchange of currencies.

Production risk : Uncertainties the surrounding the occurrence of:
- failure of machinery to function economically;
- failure to solve technical problems;
- exhaustion of raw material resources;
- strikes, absenteeism, labour unrest.

Personal risk : Uncertainty surrounding the occurrence of:
- unemployment;
- poverty from factors such as divorce, lack of education or opportunity, loss of health from military service.

or marine insurance is a contract of indemnity under which the insurer or underwriter promises to indemnify the insured in case of any financial loss suffered by her/him on the happening of the event. In other words, the insurer undertakes to compensate the insured for the loss caused to her/him by the damage or destruction of the property insured. The compensation payable and the loss suffered are to be measured in terms of money.

It should be noted that the principle of indemnity is not applicable

to personal insurance, such as life insurance because a contract of life insurance is not based on the principle of compensation. How can a person or his heir be compensated for his death?

Purpose of all contracts of indemnity is to put the insured in the same position after the event happened in which she/he was immediately before that event. Let us take an example of fire insurance. Suppose the insured has taken a fire policy on her/his house and the house catches fire. She/he will be compensated for the damage caused to the house by fire. But she/he is not permitted to make profit out of this event. The sum for which the house is insured is fixed by the insured and should represent as accurately as possible the value of the house. But this sum is only the maximum amount, which the insured can recover in the event of loss caused by fire. Subject to this maximum limit the actual amount of compensation will be determined by the extent of damage caused by fire.

The objective behind making insurance of property subject to the principle of indemnity is to see that the insured does not make any profit by recovering more than the amount of actual loss to her/him by the event insured against.

Such insurance may be for a sum less than the actual value of the property but usually it should not be for more. Where the insured takes a policy for a sum more than the real value of the property she/he will get only the actual value of the loss and not the whole of the sum insured.

(iv) Contribution: Principle of contribution is a corollary of the doctrine of indemnity. It applies to any insurance, which is a contract of indemnity. The insured is not prevented from taking out two policies on the same property. But in case there is a loss, when there is more than one policy on the same property, the insured will have no right to recover more than the full amount of his actual loss. If she/he recovers the full amount of her/his actual loss from one insurer, she/he will cease to have any right to obtain further payment from the other insurer. In such a case the principle of contribution will be applied by the court according to which the insurer who has paid the insured the full amount of compensation will recover proportionate contribution from the other insurer.

(v) Subrogation. The doctrine of subrogation is another corollary of the principle of indemnity. It applies to all insurance contracts. After the insured is compensated for the loss or damage to the property insured by her/him, the right of ownership of such property passes on to the insurer. Because, if the damaged property has any value left or lost property is recovered that cannot be allowed to remain with the insured because in that case she/he (insured) will realise more than the actual loss which is against the principle of indemnity. Thus, the doctrine of subrogation means in effect the substitution of the insurer in place of the insured as the rightful claimant of the rights of possession, etc.

(vi) Causa proxima: The principle of *Causa Proxima* means that in case of loss arising out of any mishap the most proximate cause, i.e., the nearest cause of the mishap should be taken into consideration. For example, suppose X has taken a marine policy to cover the goods exported by her/him. Under the policy goods have been insured against damage likely to be caused by sea water. During the voyage a hole was caused in the bottom of the ship. Through this hole sea water entered into the ship which damaged the goods insured. In this case there are two causes of the mishap, which has occurred. *First*, the hole caused in the bottom of the ship and *second*, seepage of sea water into the ship. The nearest cause of the damage caused to the goods is the seepage of the water, the hole in the bottom of the ship is the remote cause. Therefore, X must be compensated for the loss caused by the damage to the goods covered by the policy.

(vii) Mitigation: The principle of mitigation emphasises the duty of the insured to take all possible steps to minimise the loss or damage to the property covered by the insurance policy, in case the mishap happens. Take an example of goods in a warehouse covered by a fire policy. In case the warehouse catches fire, it is the duty of the policyholder (insured) to do all that she/he would have done if the goods were not insured against fire to minimise the loss or damage to the goods. Thus, this principle aims at making sure that the insured behaves as a prudent person and does not become careless after taking a policy to cover any risk.

Types of Insurance

Insurance contracts have been classified in various ways by different authors. But the most common of the classifications is one, which follows the usual practice of the insurance companies engaged in insurance business. The most common and most widely practised insurance business is divided into three branches — life, fire and marine. Many other risks are also covered by insurance, e.g., accidents sickness, bad debts, burglary, etc. But we propose to study, particularly life fire and marine insurance.

Life Insurance

To understand the need for life insurance, think of yourself as a family person. You can anticipate a certain flow of earnings in the future. You can also anticipate a certain flow of expenditures. The length of these flows is uncertain, because you do not know when you will die. This presents you with two types of risks: dying too soon and living too long.

If you die too soon, the flow of earnings will be cut off. While this will not be a concern for you personally, it will be a concern for those who depend on your earnings. These may include members of your family or business associates, who depend on your continued activity, and creditors — for example, the bank may have made you a mortgage loan.

Living too long can also be a problem. On retirement, your flow of earnings will end, while your flow of expenditures will continue. Naturally, you will prepare for your retirement by saving part of your earlier earnings. The problem is that you may outlive those savings.

Life insurance companies offer protection against these risks. Their basic products are life insurance proper, disability insurance, annuities, and health insurance. Life insurance pays off if you die, protecting those who depend on the continuation of your earnings. Disability insurance replaces part of your income if you are unable to work due to accident or illness. An annuity addresses the problem of living too long. In exchange for a fixed sum — all part of your retirement savings — an annuity pays a stream of income for as long as you live. Health insurance covers the costs of medical expenses.

What these various types of insurance all have in common is that they rely on the statistics of mortality (death) and morbidity (illness). While it is hard to predict the death or illness of a specific individual, death rates and illness rates for large populations are fairly stable and predictable. By gathering mortality and morbidity statistics, insurance companies can calculate the probabilities they need to fix premiums. By pooling a large number of individual risks, they can reduce the chance that claims will significantly exceed premiums.

Life insurance is a contract under which one person, in consideration of a premium paid either in lump sum or by monthly, quarterly, half-yearly or

Evolution of Life Insurance Business

Life insurance in its modern form is a western concept. Although it has been taking shape for the last 300 years, it came to India with the arrival of the Europeans. The first life insurance company was established in India in 1818 as Oriental Life Insurance Company mainly to provide for widows of Europeans. The companies that followed mainly catered to Europeans and charged extra premium on Indian lives. The first Indian Company insuring Indian lives at standard rates was Bombay Mutual Life Insurance Company, which was formed in 1870. This was the year also when the first Insurance Act was passed by the British Parliament. The years subsequent to the Swadeshi Movement saw the emergence of several insurance companies. At the end of the year 1955 there were 245 insurance companies and provident societies out of which 16 were non-Indian companies. All the companies were nationalised in 1956 and brought under one umbrella – The Life Insurance Corporation of India (LIC) – which enjoyed a monopoly of the life insurance business till near the end of 2000. By setting up the Insurance Regulatory Development Authority in April, 2000 the government of India effectively ended LIC's monopoly and opened the doors for private insurance companies.

yearly payments, undertakes to pay to the person for whose benefit the insurance is made, certain sum of money either on the death of a person whose life is insured or on the expiry of a specified period of time. The person who agrees to indemnify is called the *insurer*. The person whose life is insured is called the *assured*. The consideration paid to the insurer is called the premium.

Kinds of Policies

Policy, as explained earlier, is a document containing the written contract between the insurer and the insured setting forth the terms and conditions under which the insurance policy is issued. It is issued to the proposer after the insurer accepts the proposal form duly filled in and signed by her/him and the first premium is paid. There are different kinds of life insurance policies.

Besides, those given in the box below, the whole life assurance and endowment assurance are the most popular forms of life assurance policies.

(i) Whole life assurance policy: Under this form of policy the insured sum becomes payable to the beneficiary only on the death of the assured. It means that the whole life policy is to run for the whole life of the assured. The premiums on such

A Profile of Packages

- **Jeevan Mitra**: Double benefit endowment assurance policy with additional insurance cover equal to the sum assured in the event of death before maturity.
- **Jeevan Sathi**: A joint life insurance for couples. Assured sum, immediately payable in the event of death of one of the partners, to the survival partner who need not pay further premiums. The policy is kept alive and will continue to earn bonuses declared on the basis of yearly valuations. Once again, the basic sum assured with bonuses is payable to the survivor or partner on the date of maturity or to the nominee in the event of death of the surviving partner before the date of the maturity. If both partners survive the selected term, the basic sum assured with bonus is paid on the date of maturity to the first named partner.
- **Money Back Policies**: Suitable for those who periodically need lumpsum payments. Provides risk cover and lumpsum payments.
- **Jeevan Surabhi**: An improved version of Money Back Policy. Provides increasing life insurance cover with lumpsum payments at short intervals and limited premium paying term.
- **Bima Sandesh**: Low-premium term assurance plan. Premium is paid only on survival.
- **Jeevan Kishore**: (Exclusive plan for children aged 7 and above), **Jeevan Sukanya** (ideal scheme for the girls aged 1-12), **Jeevan Griha** (specially designed for those who need a house), and **Jeevan Akshay** are the pension plans.

policies may be payable for fixed period (say, 20 or 30 years) after which the payment of premium ceases but the policy runs on till the death of the assured. Alternatively, if the premium is payable throughout life, it is called whole life policy.

(ii) Endowment life assurance policy: Under this type of policy, the insurer undertakes to pay the assured a specified sum on the attainment of a particular age or on his death, whichever is earlier. In case of the death of the assured before he attains the specified age, the sum is payable to her/his legal heir or the nominee. Thus, the endowment policy matures after a limited number of years.

Health Insurance

Premature death is a financial threat because this peril cuts off income needed to support a family, pay debts, or educate children. Disability resulting from illness or accident may be an even greater peril to family because it not only cuts off income but also creates large medical expenses. Insurance can transfer the burden of the costs of illness or accident so that people do not have to face financial ruin because of poor health. The financial loss from ill health stems from two separate sources — lost income and medical expenses. Individual or group health insurance policies can cover both these loss exposures.

Kinds of Health Insurance Coverage

(a) **Basic medical expense:** First rupee coverage for expenses of hospitalisation and doctor's services.

(b) **Major medical expense:** Coverage for the cost of catastrophic illness.

(c) **Disability income:** Replaces income lost while the insured is unable to work.

(d) **Medical supplement:** Fills gaps in medicare programme of social security.

(e) **Long-term hospitalisation:** Covers nursing home bills for elderly people.

Fidelity Insurance

Fidelity insurance is used to protect an employer from the dishonesty of an employee. Banks, loan companies, and other businesses commonly use such insurance policies for cashiers and other employees who handle company funds. The employer is insured against loss upto the amount of the policy.

Fire Insurance

Under a fire insurance contract, the insurer, in return for the premium paid by the insured, undertakes to pay or make good loss suffered by the insured as a result of damage caused by fire to the property covered by the policy. We know that business assets and property are exposed to the risk of fire. But, it cannot be known in advance as to who is going to suffer in any particular year. Therefore, the heavy burden of uncertainty hangs over every business firm. Fire insurance removes

the uncertainty of loss by protecting all those members of business enterprises who insure against fire. The insurer charges the premium from all those insuring against fire hazards and makes good the losses suffered by the actual victims of fire.

Thus, the burden of fire losses is spread over all members who have taken fire policies. Every individual is relieved from the horror of fire losses to which she/he is exposed. In effect, fire insurance equalises heavy fire losses of a few individuals by distributing the same over a large number of persons held together by the ties of insurance. This encourages individual enterprises and gives them a feeling of security.

Principles of Fire Insurance

All the principles of insurance explained earlier, such as, utmost good faith, insurable interest, and indemnity apply to fire insurance as well.

Indemnity is by far the most important principle of fire insurance. Contracts of fire insurance are contracts of indemnity. Under a fire insurance contract, the insurer undertakes to compensate the insured for loss or damage to the property caused by fire. Compensation may be in the form of payment in money or replacement or repair of the property damaged by fire. The purpose of compensation is to place the insured in the same financial position as she/he was before the loss or damage was caused.

Nature of Fire Insurance Contract

A contract of fire insurance is a contract under which the insurer, in consideration of a premium, undertakes to indemnify the insured against

Evolution of General Insurance

The saga of general insurance in India like many other service industries is a story of early foreign (mostly British) ownership, followed by Indian enterprise. The first general insurance company, entirely owned by the British in the name of Triton Insurance Company, was set up in Calcutta in 1850, while the first company in the name of Indian Mercantile Insurance Company was set up only in 1907. Even at the time of independence foreign insurers had 40 per cent share of the general insurance business, which declined gradually over time.

A voluntary form of self-regulation was first introduced in 1957 through a code of conduct drawn up by the General Insurance Council, a wing of the Insurance Association of India, and administered by the Controller of Insurance, whose office was set up only in 1957 at Delhi with branch offices in other metropolitan cities. Beginning with social control introduced in 1968 the government sought to have a greater say in the running of the industry, which was to culminate with an outright nationalisation with effect from January 1, 1973. By the end of 20th century, general insurance business has also been opened up for private companies.

loss or damage to property by fire during an agreed period. The document which contains the terms and conditions of the contract is known as the policy. The subject matter of the contract is the insured property.

Usually, a fire policy contains the name of the parties, description of the insured property, the sum for which the property is insured, amount of premium payable and the period insured against. Generally, the period of insurance is one year. But, 15 days of grace are allowed for renewal of the policy.

Fire insurance provides protection against loss or damage by fire, lightening and explosion. Fire for this purpose means actual fire or ignition and it should be accidental and not intentional. Any damage done in the exercise of powers, in case of an outbreak of fire, by the fire brigade or any other municipal or civil authority by way of breakage, pulling down of premises, etc., is also covered by the term fire losses. Fire policies include loss through fire caused by riot, civil strife, rebellion, insurrection or foreign enemy.

Kinds of Fire Insurance Policies

To meet the varying demands of the insured parties, different kinds of fire policies (specific policy, valued policy, average policy, floating policy, adjustable policy, comprehensive policy, blanket policy, and consequential loss policy) are issued. More common among them are the following:

(i) Specific policy: Under a specific policy the insurer undertakes to pay or make good to the insured any loss or damage by fire which may happen to the property insured upto the amount of the sum specified against that particular property in the policy.

(ii) Double insurance: When more than one policy is taken to cover the same risk, it is called *double insurance*. Any person is free to insure her/his goods or property against fire or perils of the sea under more than one policy. But, in such cases, the insured cannot recover more than the insured value of property from his insurers. All the insurers with whom she/he has insured will be liable to pay only a ratable proportion of the loss suffered by the insured.

Suppose, a house worth Rs 20000 has been insured against fire under two policies, each for Rs 20000 and the house is destroyed by fire. The insured cannot claim Rs 20000 under each of the policies. Because, according to the principle of indemnity he cannot make a profit. If he is allowed a claim of Rs 20000 on each of the two policies, he will make a clear gain of Rs 20000. Therefore, it is provided under law that in such a case the insurer of each policy will pay him proportionately, e.g., the insured will receive Rs 10000 on one policy, and Rs 10000 on the other. In aggregate she/he gets Rs 20000 the amount of full compensation.

It may be noted that in case of life insurance any number of policies are allowed and payment under each

policy to the extent of the sum assured has to be made by the insurer. Thus, the meaning of double insurance explained above does not apply to life insurance. This is because of the unlimited extent of insurable interest in a man's life.

Reinsurance

It refers to the arrangement under which an insurer enters into contract with another insurer for the assumption of a part or whole of the risk insured by the first insurer. In other words, the reinsurer undertakes to insure the first insurer against loss from some or all of the risks she/he has insured. This may be done in several ways. The re-insurer may agree to cover all losses beyond a specified amount. She/he may agree to cover a proportion of every loss or the total of all losses over a specified amount during a given period. A contract of reinsurance, like any fire insurance contract, is a contract of indemnity. It also requires utmost good faith.

It should be noted that this is a contract between an insurer with another insurer who may be called *re-insurer.* The insured under the original policy has nothing to do with the re-insurer. The contract between him and his insurer and the contract between his insurer and the re-insurer are two separate contracts quite independent of each other. If there is any loss, the re-insurer will pay the insurer after she/he has indemnified the original insured.

Reinsurance has many advantages. *Firstly,* it enables a wider distribution of risk. *Secondly,* the insurer can contract to indemnify more risks. *Thirdly,* it stabilises income and losses over a period of years. *Fourthly,* it enables the insurer to undertake to indemnify even for risks involving very large amounts. Thus, the insured need not enter into contract with different insurers to cover large risks.

Marine Insurance

It is a contract under which the insurer or underwriter undertakes to indemnify the insured against losses, incidental to marine adventure. It may be defined as a form of insurance covering loss or damage to vessels or to cargo during transportation on the high seas. The risks insured against are those commonly known as perils of the sea, such as a storm, collision of one ship with another, against rocks, etc. and fire as well as action of the master or crew of the ship.

Thus, it is a device to secure protection from loss or damage to property in shipment. The insured finds her/his interest (in the property on the ship or the cargo freight) protected from many risks of overseas transport. Such risks include collision, burning and sinking of the ship, spoilage of the cargo from seawater, mutiny, piracy or willful destruction of the ship and cargo by the master (captain) of the ship or the crew.

It follows from the above discussion that marine insurance is a

contract between the insured and the insurer. The insured may be a cargo owner or a ship owner or a freight receiver. The insurer is known as the underwriter. The insured pays a particular sum, which is called *premium*, in exchange for an undertaking from the insurer to indemnify the insured against loss or damage caused by certain specified perils known as perils of the sea. Marine insurance may be cargo insurance, hull insurance (when the whole ship is insured) or the freight insurance.

Difference between Life Insurance and General Insurance

(i) In the case of life insurance the risk involved for the assured is not uncertain as in the case of fire or marine insurance. Death of a person or her/his reaching a particular age is certain, only the time of its occurrence is not known. Therefore, in case of life insurance every policy is sure to become a claim some time or the other. In case of fire or marine insurance, it may or may not become a claim since the outbreak of fire or a marine evil is not certain to happen.

(ii) Unlike fire and marine insurance, life insurance protects persons against the loss of future earning power or income needed for financial support of the family and dependents and for payment of accumulated debts.

(iii) Life insurance is never a protection against partial loss as is the case with fire or marine insurance.

(iv) Life insurance is a contract of guarantee whereas fire and marine insurance are contracts of indemnity.

(v) Life insurance is taken for a much longer period than fire or marine insurance.

(vi) Life insurance contains both the elements of protection and investment whereas in case of fire or marine insurance only the protection element exists.

(vii) In the case of life insurance it is enough if the insurable interest exists at the time policy is effected. In case of fire it must exist both at the time when contract is made and at the time of loss. In case of marine insurance insurable interest must exist at the time when loss or damage occurs.

(viii) In the case of life insurance the premium once fixed for a particular contract cannot normally be altered, although the risk goes on increasing with age. In the case of general insurance, the premium may be altered at the time of renewal after a year.

(ix) The assured can surrender a life insurance policy before its maturity. In such a case, the insurer is relieved from the liability under the contract. In case of a fire or marine policy, the insured cannot do so.

(x) Medical examination of the person whose life is assured is necessary

in case of life insurance. No medical examination is required for fire or marine insurance.

(xi) The question of over or under insurance does not arise in case of life insurance but is possible in case of marine or fire insurance.

(xii) The gradation of risks is generally, more simple in life insurance than in other forms of insurance.

4.3 Communication

In any business, no matter whether it is large or small, there is abundance of record keeping, decision-making, planning, coordinating, and so forth. These different activities may be similar or very diverse in nature, and they may be carried on by many people or by only a few. In any case, however, the results of such business activities are of very little use unless they can be communicated. So long as the information is retained at its points of origin, it might as well never have been created or accumulated at all.

Since the product of most business activities is intended to be communicated, the supposition that this would happen hardly makes sense. It does, however, serve to emphasise the importance of the central theme of this chapter — that the success of business activities is dependent in large measure on the efficiency of its communications systems.

The range of communication systems which are now available to a business may be broken down into two categories: (a) Internal — company mail service, messenger system, internal telephone network, intercom connections and closed circuit televisions; (b) external — governmental postal service, telegrams or cablegrams, teletype network, public telephone system, e-mail, etc.

4.3.1 Postal and Telecom Postal Services

The government at national and international level provides postal services. These services are reliable but slow in speed and bureaucratic in nature. All the postal services are run and controlled by the government. Now-a-days, post offices also provide a number of financial services besides postal services. Due to bureaucratic procedure and slow speed of postal services, business houses rely more on courier services (run by private organisation) than postal services. Post offices have also started speed post services to counter the growing importance of courier service. Another important service provided by the post offices is that of telegraphic communication. Though it was very effective in earlier times, it has lost its importance due to the advent of high-speed communication systems like e-mail.

Telecom

Telephone is a very versatile method of business communication. And, it has been modernised and expanded continuously throughout history. Today, it is by far the most widely used communication device, both within an organisation and between distant

points (STD and ISD). Till recently, it was under the total monopoly of the government but now most of the modern telecom services have been privatised. The principal benefit, which a business should expect from the use of telephones, is speed. The low-cost of a telephone message and the privacy afforded should also be cited as advantages of this medium. The principal drawback of telephone services is the transitory nature of telephone calls, which cannot be retained or offered for proof (unless recorded).

4.3.2 Recent Trends in Communication

Looking into the limitations of the telecom devices of communication, some more efficient devices of communication have been innovated. Most recent developments in the area of communication are fax, internet and e-mail, etc.

Fax

Fax machines being electronically operated, are interconnected with telephone systems. Thus, fax machines (facsimile system) have revolutionised the communication system by being much faster and more efficient, especially, in the area of commercial communications. Basically, fax machine is nothing but adding video technology to the existing teleprinting. This facilitates instant decision-making, wherever the perusal of documents is necessary. Fax machines can communicate images which would mean scripts, original documents, drawings and designs, etc., and Thus, bring the ultimate communication by images at lightening speed and down to earth cost. There are various fax machines available for use. These differ in their efficiency, capabilities, speed etc. However, the basic uses and work remains the same in each case. Fax form of communication has a definite edge over other forms of communication like postal mail, telephone, telex and courier. The benefits rendered by the fax system are evident from the comparison chart given on next page.

Internet

Internet is the world's largest computer network, the network of networks, scattered all over the world. It was created nearly thirty-five years ago as a project for the US Department of Defence. Its goal was to create a method for widely separated computers to transfer data efficiently even in the event of a nuclear attack. From a handful of computers and users, today the internet has grown to thousands of regional networks that can connect millions of users. Any single individual, company or country does not own this global network. We live in the information age, where knowledge is power. The internet helps in three obvious ways: (a) to get information; (b) to provide information; and (c) to compile information. Internet facilitates the creation of website that could be a source of continuous information about the various facets of organisation. This could be updated from time to time.

E-Mail

The conventional mailing by post can take several days to travel across the country and weeks to go around the world. That is why now-a-days it is referred to as *snailmail*. In recent times, e-mail or electronic mail is being used to send and receive messages. It saves time and money, is fast, easy to use and less expensive than the post. You can send e-mail practically to anyone anywhere in the world. In its simplest form, e-mail is an electronic message sent from one computer to another. You can send or receive personal and business related messages with attachments like pictures or other documents. Just as a letter or document stops at the different postal stations along its way, e-mail is passed from one computer to another as it travels along the network. Each computer reads the mail address and routes it to another computer until it eventually reaches its destination. It is then stored in an electronic mailbox. With the internet, this whole process usually takes just a few minutes, allowing you to communicate quickly and easily with millions of people around the world anytime of the day or night, for the cost of a local phone call. Comparative benefits of each mode of communication is given alongside.

Comparative Benefits of Alternative Modes of Communication

Alternatives	*Benefits of Fax*
Post	: Much faster; More secure.
Telephone	: More economical; Permanent record; No language problem.
Telex	: More economical; Transmits graphics; Faster; No special preparation; No operating skills.
Courier	: Faster; Much more economical; More secure.

Extranet

The concept of extranet technology is to enable manufacturers, suppliers and customers to establish a walled-off section of the internet. This section is in effect a virtual private network, which the users can use in order to streamline their trading activities. For example, the suppliers can monitor the manufacturer's work-in-progress whilst potential customers can get feedback on product modifications.

World Wide Web (WWW)

First, created in the early 1990s, the World Wide Web (www) is the fastest developing sector of the internet. The reason for the www's popularity is primarily concerned with its enhanced user-friendly navigation features and the general manner in which information is presented. *Firstly*, the server computers, which support the www, operate on an established protocol known as the Hypertext Transfer Protocol. As a result of this protocol, users engage mouse driven

icons or text known as hyperlinks to allow them to pass automatically from one database to another without the need of complex path commands. *Secondly*, the www is that part of the Internet which enables information to be displayed in an intuitive and friendly manner through the use of various media such as pictures, photos, videos and sound. The information itself is formatted in a data structure usually known as a web page. Web pages are composed with the aid of high level programming languages/applications such as the Hypertext Markup Language (HTML). In order to traverse the www and download web page information users need a computer application known as a web browser.

Individuals and organisations currently use www all over the world as a potent point of contact. With the www, communication between the customer and retailer/service provider is not only cheap and efficient but also, because of its multi-media based technology, seductive and interesting. www commercial activity has been of particular benefit to smaller companies. The relative anonymity of the internet and the overall professional effect of sophisticated web site enabling users to ponder on a wide range of products/services have led to the birth of the *virtual corporation*. As a result, companies/individuals with the minimum of capital outlay have been able to enjoy the full benefit of trading by connecting with other traders and making deals.

Voice Mail

It is a computer-based system for receiving and delivering incoming telephone calls. Incoming calls are never missed when the phone owner is absent because a voice responds to the caller and invites a message, stores it, and delivers it when instructed to do so by the caller. A company with voice mail has each employee's phone networked for receiving, storing, and forwarding calls. Voice mail consists of software that links the communications device (telephone) with the computer. The input from the telephone is sent to the computer, which digitises the voice data and stores it on a disk. The employee can then call the voice-mail centre to retrieve from storage a recording of waiting calls and voice messages.

Unified Messaging Services (UMS)

It refers to an umbrella of existing communication services brought together for the benefit of the customers. UMS makes it possible to consolidate various forms of messages and convert them into other forms. Hypothetically, if all the communication devices — phone, PDAs, computer, pager — were put together, you would get an UMS device. UMS means converting voice messages, SMS, phone calls, fax, and any other form of message into a form which fits the device the customer is using. For instance, fax message can be converted into a voice mail message for a customer who does not have a fax

machine but has a phone. Similarly, an e-mail message can be converted into a fax if the customer desires. This means you can have one *inbox* where all your e-mails, voice messages, phone calls can be received.

4.4 Warehousing

Warehousing is the assumption of responsibility for the storage of goods. It consists of a variety of special features and institutional arrangements that have significant effect on the physical distribution of goods in particular and the efficiency with which all other business activities are performed in general. It is concerned with the establishment, maintenance and management of warehouses for the storage of goods. Warehousing is mainly concerned with the provision of storage facilities.

Functions of Warehousing

Warehousing performs following important functions in the field of business in general and marketing of goods in particular.

(i) Storage: Basic function of a warehouse is to store large stocks of surplus products. Goods which are in surplus are stored, preserved and made available for meeting the demand when their supply is relatively scarce and Thus, creates time utility.

(ii) Price stabilisation: As a corollary to the first function, warehousing equalises supplies from one time to another. Thus, fall in the prices of goods when their supply is at its peak and rise in their prices in the slack season is avoided. Prices of such goods whose supplies are irregular are stabilised.

(iii) Risk bearing: Once goods are handed over to the warehouse-keeper for storage, whole responsibility of the goods so stored passes on to the warehouse keeper. Thus, the risk of loss or damage to goods in storage is borne by the warehouse-keeper.

(iv) Financing: Warehouse keeper advances money to the owner on security of the goods deposited in his warehouse.

(v) Breaking the bulk: The warehouses take representative samples and break-up large stock into smaller parcels.

(vi) Packaging: They open and repack goods at the time of inspection by the custom authorities.

(vii) A distribution centre: They deliver goods, in whole or in part, to the buyers as per instructions of the depositor of these goods.

(viii) Grading: They prepare goods for sale by arranging them in suitable lots according to their grades.

Types of Warehouses

(i) Private warehouses: Private warehouses are those, which are, owned by large business houses or wholesalers for the storage of their own stocks. They are privately owned and constructed for the use of the owners who may be manufacturers, wholesalers, or retailers. Because of the heavy cost of construction private

The Future of Warehousing

Technological advances and faster, more reliable transportation that make it possible for companies to operate with much smaller inventories are transforming the nature of warehousing. To serve in today's competitive marketplace, tradition inventory storehouses are making radical changes to become effective supply chain partners.

For example, one significant trend is the increased use of cross docking, an approach whereby products received at a warehouse are immediately shipped out without ever being put into storage. With computerised information systems, warehouses can pre-assign a shipping door for each inbound carton. When the shipment arrives, a receiving dock employee can quickly apply a bar-coded-shipping label that includes destination data, and place the carton directly on an outbound vehicle. Cross docking is even changing the configuration of the warehouse. Although traditional warehouses are square, with truck doors on one side and rail doors on the other, combination storage/ cross-dock warehouses look more like a modified U with storage at either end and cross-docking areas in the center. Goods are received through the cross-dock area and moved directly to shipping doors or, if necessary, to short-term storage, which minimises the distance goods have to travel within the warehouse.

Warehouses are also providing more value-added services such as packaging, assembly, consolidation, end-aisle display creation, labeling, bar coding, and automatic shipment notifications. Warehouses can often provide these services to manufacturers at a lower cost than the manufacturers could manage themselves. For many public warehouses, these services comprise as much as 50 per cent of the activities.

With more and more companies eliminating inventory, warehouses are performing fewer storage functions. Instead, they are growing adept at keeping products moving quickly and accurately. This requires sophisticated computer information systems (and computer-literate warehouse employees) to minimise storage costs and time while maximising quality service to warehouse customers. The best warehouses are therefore reinventing their role as supply chain partners by becoming expertly managed *flow-through* centres.

warehouses are found in much smaller number than public warehouses.

Private warehouses may be in separate buildings or they may be in the general-purpose establishments wherefrom warehousing functions are carried on along with the other activities of the firm. Examples are those of the wholesale and retail traders.

Private warehouses are economically feasible under the following conditions:

(a) When the immediate availability of goods is essential to meet the requirements of the business;

(b) When relatively full utilisation of storage facilities is possible due to regular need of known qualities of storage space;

(c) When highly specialised facilities are essential to meet the technical requirements of business or marketing of particular commodities.

(ii) Cooperative warehouses: These warehouses are owned, managed and controlled by the cooperative undertakings. In India, the National Cooperative Development Corporation is developing cooperative warehouses. Cooperative marketing societies also provide warehousing facilities to their members.

(iii) Government warehouses: These are warehouses owned, managed and controlled by organisation in the public sector. Warehouses of the Central and State Warehousing Corporations, Food Corporation of India, State Trading Corporation, etc., are the examples.

(iv) Public warehouses: A public warehouse or duty paid warehouse is one, which operates to store goods of any member of the public in return for a storage fee or charge. Public warehouses are held to be public utilities. They are licensed by the state. Their methods of operation and rates of charges are regulated by the government.

Buildings of the public warehouses are specially designed to protect goods from several types of risks. They are constructed at favourable points on railway routes and main roads. Thus, they offer very good transport facilities for the movement of goods both by rail and road. Public warehouses are of great help to small manufacturers who cannot afford to construct their own private warehouses for the storage of goods. Even large manufacturers prefer to make use of these warehouses to stock goods in different centres for economical distribution of the product.

Factors influencing a decision in selecting private or public warehouse is given on next page.

Suitability of Public Warehouses

(a) When a manufacturer does not have sufficient storage space of his own.

(b) In case of manufacturers of seasonally produced goods, such as sugar.

(c) When goods are produced in large quantity in expectation of rise in prices.

(d) In times of unexpected slump in demand.

(e) In case storage space is needed only for a part of the year, it is cheaper to get on rent the necessary space rather than own it.

(f) When storage space is needed quickly or unexpectedly.

(g) If warehouse receipts are to be used as security for securing bank loans.

(v) Bonded warehouses: Bonded warehouses are those warehouses which are licensed by the government to accept imported goods for storage before the payment of customs duty by importers of such goods.

Importers are required to pay custom duties on the goods imported by them. Without making payment of duties they cannot remove these goods from the dock. However, by securing special permission of the customs authorities, they can keep such goods

Factors Influencing the Public/Private Warehousing Decision

Factors	*Public Warehouses*	*Private Warehouses*
Operating costs	Higher due to inclusion of profit factor, selling and advertising costs	Ten per cent to twenty five per cent lower if sufficient volume is stored
Initial investment	None	Large facility, start up, equipment, trained personnel
Costs control	Good, due to incentive to perform on short term contract	Direct responsibility over personnel and procedures
Risk	Minimal	Risk of obsolescence due to change in technology or demand
Tax advantages	Free-port state, real estate taxless no property advantage	Depreciation allowance
Economies of scale	Possible due to serving many customers	Dependent on company's volume
Consolidation of shipments	Can consolidate to warehouse and from warehouse to customer	None
Storage and Handling costs	Known exact charges for decision-making	Generally, only estimated

in licensed warehouses before the payment of import duties. But goods stored in these warehouses cannot be removed before the payment of import duties. The owners of these warehouses have to give an undertaking that duties will be collected before goods are removed from the warehouse. Such warehouses are called bonded warehouses. And goods stored therein are said to be *in bond*.

By storing their goods in the bonded warehouses importers gain some control over their goods even before they have paid duties on them. They can remove these goods in part, that is in small quantities, as and when they are sold, after making payment of the duty and warehousing charges on only part of the goods which they want to remove.

These warehouses may be owned by the dock authorities or may be privately owned. They have to work under the close supervision and control of custom authorities.

SUMMARY

Service sector: This is emerging as an important segment of Indian economy. Service sector activities may include : travel; transportation; advertising; telecommunications; consultancies; banking; insurance; etc.

Financial services: These constitute all activities involved in the transformation of savings into investment. Important financial services are: banking, insurance, merchant banking; mutual funds; factoring; venture capital; etc.

Banking: A bank is an institution that attracts money on deposit for the purpose of being lent to industry or trade. Banker is not only a moneylender but he /she also borrows funds from others. Hence, a banking institution is that which accepts money on deposits, repayable on demand and which earns a margin of profit by lending such money. The main features of banks are: (a) role of an intermediary; (b) mobilises capital; (c) play the role of creditor and debtor; (d) creator of money; (e) custodial services; (f) instruments of innovation; and (g) agency services. Commercial banks are of three types: (a) public sector banks; (b) private sector banks; and (c) foreign banks. The key functions of commercial banks are: (a) collection of deposits; (b) granting of loans and advances; (c) collection of cheques and bills; (d) personal services; (e) buying and selling of shares and debentures; (f) custodial services; (g) provision of remittance facilities; (h) issue of letters of credit; (i) issue of travellers' cheques; (j) provision of credit information; and (k) electronic services.

Insurance: This is a form of contract or agreement under which one party agrees in return for a consideration to pay an agreed amount of money to another party to make good a loss, damage, or injury to something of value in which the insured has a pecuniary interest as a result of some uncertain event. Thus, insurance is a mechanism of minimising business risks. The concept of insurance is based on the principle of pooling and sharing of risks with others. General principles governing insurance are: (a) the utmost good faith; (b) insurable interest; (c) indemnity; (d) contribution; (e) subrogation; (f) causa proxima; and (g) mitigation. There are mainly three types of insurance: life, fire and marine. Life insurance offers protection against the risk of life, disability, and health of the insured. Main life insurance policies are whole life assurance policy and endowment life assurance policy. Fire insurance is the protection against a loss suffered by the insured as the result of damage caused by fire to the property covered by the policy. In marine insurance, the insurer undertakes to indemnify the insured against the losses incidental to marine adventure.

Business communication: This is concerned with the passing of business information from one place or person to another. The communication system used for this purpose can be divided into two groups: (a) internal: company mail, messenger, internal telephone network, intercom, and closed circuit televisions;

(b) external: governmental postal service, telegrams, cablegrams, public telephone systems, e-mail, etc. Modern systems of telecommunications are fast and economical compare to traditional systems. Internet, e-mail, fax, extranet, www, voice-mail, and unified messaging services revolutionised the business communication system in the world.

Warehousing: These services in modern business play an important role in distribution of goods and services. The important functions of warehousing are: (a) storage; (b) price stabilisation; (c) risk bearing; (d) financing; (e) breaking the bulk; (f) packaging; (g) a distribution centre; and (h) grading. There are different types of warehouses. Most prominent of them are: (a) private warehouses; (b) cooperative warehouses; (c) government warehouses; (d) public warehouses; and (e) bonded warehouses.

EXERCISES

Short Answer Type Questions

1. Define the term 'bank' and discuss its features.
2. Define services.
3. Explain the nature and types of financial services.
4. Define insurance.
5. Why is insurance a necessity rather than a choice for a business?
6. What is life insurance?
7. Discuss the importance of life insurance.
8. Distinguish between fire insurance and marine insurance.
9. Who have insurable interests in case of a marine insurance policy?
10. Distinguish between the terms 'insurance' and 'assurance'.
11. What is marine insurance? How it is different from fire insurance?
12. Who have insurable interest in case of a life policy?
13. What is business communication?
14. How are modern instruments of communication superior than postal system of communication?
15. Explain the suitability of bonded warehousing facilities to business.

Long Answer Type Questions

1. What are the main functions of commercial banks?
2. What are the fundamental principles of insurance?
3. Discuss any three general principles of governing insurance.
4. What is fire insurance? Explain the principles of fire insurance.
5. What are the major instruments of business communication?
6. Bring out clearly the need and importance of warehousing services.

Project Work

Title	:	Survey of popularity of credit cards issued by different banks.
Objective	:	To encourage students to understand how credit companies have responded to an economic environment characterised by falling and low interest rates.
Coverage	:	Factors that have made credit cards popular like interest rate, fee, incentives, inducements, user-friendly and so on.
Material	:	Questionnaire.
Methodology	:	Let each student to visit to one of the card managers (American Express: The American Express card and the Optima card, Citibank: Master card and VISA, SBI: Gold card, Canara bank: Can card, BP: Petro card, etc.) and research (through questionnaire) the ways in which the credit cards issuer responded to falling interest rates in the recent past and to overcome the negative impact of this on profitability, which action (s) did it take. After this, join in teams with other students who researched other cards to compare and contrast your findings in the class under the guidance of the instructor.
Follow-up	:	(a) *In what ways did falling interest rates affect the entire* credit card marketing environment? (b) What card offers the most favourable terms to customers? To merchants? The least favourable terms?

CHAPTER 5

Forms and Formation of Business Enterprise

LEARNING OBJECTIVES

After studying this chapter, you should be able to :

- identify the different forms of business enterprises;
- explain the features, merits and limitations of each form of business enterprise;
- examine the factors to be considered for selecting a suitable form of organisation;
- analyse the factors to be considered for setting a business;
- examine the scope for setting small business.

5.1 Introduction

Every business entity adopts some form of business organisation to carry out business activities. For the private sector in India (i.e., business run by private individuals) the forms of business organisation/enterprise are the following:

- Sole proprietorship;
- Joint Hindu Family Business;
- Partnership;
- Cooperative Society;
- Company.

In this chapter we shall discuss various aspects of different forms of business organisation, their relative advantages and limitations, as well as the scope of setting up small business enterprises.

5.2 Sole Proprietorship

A business owned, managed and controlled by a single individual is known as a sole proprietorship organisation. The individual is referred to as the sole proprietor and is responsible for all business decisions. She/he has ownership of all business resources. All profits earned belong exclusively to her/him and all losses incurred are to be borne by her/him. In running the business, however, she he can take the help of his family members and also employ persons as assistants or manager. Legally the business and the individual are the same, in the sense that the sole proprietor is personally liable for all the debts that are incurred in the course of business. In the case of trading firm, the sole proprietor may also be referred to as *sole trader.* Most small concerns adopt this form of business organisation because of its several merits.

5.2.1 Features of Sole Proprietorship

The features of sole proprietorship are mentioned below:

(i) Individual ownership: The business is owned by a single individual.

(ii) Risk bearing: The proprietor is the sole beneficiary of all rewards/ profits. Likewise, if there are losses, she/he alone has to bear them. Thus, she/he alone bears the risk of the business venture.

(iii) Unlimited liability: In the case of business losses, if the business assets are not sufficient to meet all business liabilities, the proprietor may have to sell his personal property to pay off the liabilities.

(iv) Freedom of operation: There is minimum government regulation and the proprietor enjoys substantial freedom of operation in a sole proprietorship concern.

(v) Control: The proprietor is the sole owner of the firm and has full control over it. Even if she/he appoints a manager, she/he retains the control of the business.

5.2.2 Merits of Sole Proprietorship

The merits of sole proprietorship are as follows:

(i) Ease of formation and closure: A sole proprietorship organisation is easy to form. There is hardly any legal formality involved in

setting up this type of organisation. It is not governed by any specific law. The business activity should be lawful, comply with the rules and regulations laid down by local authorities, and obtain the necessary license if any. Also, the business can be closed whenever the proprietor desires.

(ii) Flexibility of operations: In a proprietor business, all decisions are made by a single person. There are no delays and the business can quickly adapt itself to the changing environment. This provides flexibility to the business.

(iii) Sole beneficiary of profits: The profits earned in course of business belong only to the sole proprietor. There is a direct relation between effort and reward. This motivates him to work hard.

(iv) Suitability for small-scale operations: The sole proprietorship form is generally, adopted for small-scale business and where personal attention to details is required. Further, where the capital outlay is small and restricted to one's own savings, sole proprietorship concern is the appropriate form of organisation.

5.2.3 Limitations of Sole Proprietorship

Sole proprietorship form of organisation suffers from certain limitations which are ;

(i) Unlimited liability: The sole proprietor is personally liable for all business obligations. For payment of business debts, her/his personal property can be used if the business assets are insufficient.

(ii) Limited access to capital: The sole proprietor has limited scope for raising capital. His own funds may be insufficient for expansion. This reduces the scope for business growth.

(iii) Limited managerial skills: Business skills are required in many areas. The lack of knowledge and managerial ability of the sole proprietor in all fields is another factor which limits the prosperity and growth of the business.

(iv) Lack of continuity: The business is dependent on a single individual. If that individual falls ill or becomes insane or insolvent, the business gets destabilised. And if he dies, the business may come to an end.

To conclude, sole proprietorship is a popular form of business organisation in India. It is particularly suited to meet the requirements of small business establishments. The local grocery store, small beauty parlours, tailoring units, and small factories are mostly organised as sole proprietorship concerns.

5.3 Joint Hindu Family Business (JHF)/Hindu Undivided Family Business (HUF)

The joint Hindu family business refers to a business which is owned by the members of a joint Hindu family. It is also known as Hindu undivided family business. This form of organisation exists under Hindu law and is governed by the law of succession. The joint Hindu family form is a form of business organisation in which the family possesses some inherited

property. The inheritance of the property is among the male members. The share of ancestral property is inherited by a member from his father, grandfather and great grandfather. Thus, three successive generations can simultaneously inherit the ancestral property. For purposes of running a joint Hindu family business, only male members are entitled who are referred to as coparceners. The oldest member is known as the *Karta*.

5.3.1 Joint Hindu Family Business

The important features of the joint Hindu family business are as follows:

(i) Membership by birth: Membership of the joint Hindu family business is automatic by birth of a male child. It is not created by an agreement between persons.

(ii) Management: The management vests in the *Karta*, the eldest member of the family. However, the *Karta* may associate other members of the HUF to assist him.

(iii) Liability: The *Karta* has unlimited liability, i.e., even her/his personal assets can be used for payment of business dues. Every other coparcener has a limited liability upto his share in the HUF property.

(iv) No maximum limit: There is no restriction on the number of coparceners of the HUF business. However, the membership is restricted to three successive generations.

(v) Minor members: A male child at the time of birth becomes a coparcener. Thus, an HUF does not restrict membership to minors.

(vi) Unaffected by death: The HUF business continues even after the death of a coparcener including the *Karta*. The next senior most surviving male member of the HUF becomes the *Karta*. However, it may come to an end if all the members notify that they are not members of the joint Hindu family.

5.3.2 Merits

Merits of joint Hindu family business are mentioned below:

(i) Economic security and status to the members: The joint Hindu family business provides members a sense of security and belonging because of the financial stake they possess in it. It also gives them status in society while dealing with others.

(ii) Continuity of business: The business has a continuity about it. It is not affected by death or lunacy of members, including the *Karta*. Till such time that the members jointly do not decide to terminate it, the business continues to exist.

(iii) Family pride: Members are likely to work with dedication, loyalty and care, because the work involves the family name. The business is not only an economic unit but also a matter of family prestige.

5.3.3 Limitation

The joint Hindu family business has the following limitations:

(i) Unlimited liability: The *Karta* is personally liable for all business obligations. For payment of business debts, his personal property can be

sold if the business assets are insufficient.

(ii) Limited access to capital: The *Karta* has limited scope for raising capital. Her/his own funds may be insufficient for expansion. This reduces the scope for business growth.

(iii) Karta too powerful: An incompetent *Karta* may ruin the business since all business decisions are taken by her/him.

This form of business organisation is perhaps the natural economic extension of the joint Hindu family. It serves to provide economic security and status to members. It continues to have an important place in Indian business.

5.4 Partnership

Partnership is an association of two or more persons who agree to jointly pursue a business activity. They pool their managerial and financial resources for the purpose. *Partnership is the relation between two or more persons who have agreed to share the profits of a business carried on by all or any of them acting for all.*

5.4.1 Features of Partnership

The features of partnership are outlined below:

(i) Agreement: There must be an agreement between the partners to form a partnership. The agreement may be oral or written.

(ii) Business: A partnership may undertake any lawful business activity, which may consist of trade, profession or industry.

(iii) Sharing of profits: In a partnership firm, partners are entitled to profits which implies sharing of losses as well unless otherwise agreed.

(iv) Number of members: There must be at least 2 members. A partnership may have a maximum of 20 members and in the case of banking business, a maximum of 10 members.

(v) Agency relationship: Each partner is an agent because she/he has the capacity to bind other partners by his acts. She/he can also be similarly bound by the actions of other partners.

(vi) Liability: The liability of partners is unlimited as in the case of sole proprietorship. Partners are individually and collectively liable to creditors of the firm. Hence, the creditors have a right to recover their dues from the private property of one or all partners when the assets of the firm are insufficient.

(vii) Ownership and control: Normally, every partner has a right to take part in the management of the business. Hence, the rights of ownership and control are jointly held by the partners.

(viii) Non-transferability of share: No partner can transfer her/his share in the partnership to any other person. She/he may, however, do so with the consent of all other partners.

(ix) Registration: To form a partnership firm, it is not compulsory to register it. However, if the partners so decide, it may be registered with the Registrar of Firms. There are several advantages of registration which have been discussed later.

(x) Duration: The partnership firm continues at the will of the partners. Legally a partnership comes to an end if any partner dies, retires or becomes insolvent. However, if the remaining partners agree to work together under the original firm name, the firm will not be dissolved and the business will be continued after settling the claim of the outgoing partner.

5.4.2 Types of Partnership

According to the nature of agreement among partners, there can be three types of partnerships as follows:

(i) Partnership at will: Such a partnership exists at the will of the partners. That is, it can be brought to an end whenever any partner gives notice of her/his intention to do so.

(ii) Particular partnership: A particular partnership is formed for undertaking a particular venture. It comes to an end automatically with the completion of the venture.

(iii) Partnership for a fixed duration: Such a partnership is for a fixed period of time say for a period of 3 years, 5 years or any other duration.

5.4.3 Types of partners

The various types of partners found in partnership firms are as follows:

(i) Active partners: Partners who take active part in the conduct of day-to-day business of the firm are called active partners. These partners carry on business on behalf of the other partners.

(ii) Sleeping or dormant partners: Sleeping or dormant partners are those who do not take active part in the management of the business. Such partners only contribute capital to the firm and are bound by the activities of other partners. However, they have a share in the profits and losses of the business.

(iii) Others: Active and sleeping partners are, as a matter of fact, the full-fledged partners, i.e. they share in profits and losses of the business and are liable for its dues. However, there are other types of partners also who may be associated with the partnership directly or indirectly. They are not full-fledged partners. Such partners may include the following:

(a) Nominal partners: Nominal partners are those who do not have interest in the business but lend their name to the firm. They do not make any capital contribution, and are not entitled to take part in management, but are liable, like other partners, to third parties. Such partners generally, have a pecuniary interest (like a share in the profits) in lending their name to a firm. However, in certain cases they may not have any pecuniary interest in doing so. For example, a reputed industrialist may, without any profit motive, lend her/his name to a firm run by her/his family members.

(b) Partner by holding out: If a person by her/his words or conduct holds out to another that

she/he is a partner, she/he will be prevented from denying that he is not a partner. The person who thus, becomes liable to third parties to pay the debts of the firm is known as a partner by holding out.

5.4.4 Minor Admitted into the Benefits of Partnership

A minor is a person who has not attained the age of 18 years. Since a minor is not capable of entering into a valid agreement, she/he cannot become partner of a firm. She/he may, however, be admitted to the benefits of an existing partnership.

It is clear from the preceding discussion that partners can be of three categories: (i) those who share in the profits and losses of the business and assume liability of the business debts (like active partners, dormant partners and nominal partners); (ii) those who share in profits only (like minor partners); and (iii) those who assume liability without sharing in the profits of the business (like partners by holding out).

5.4.5 Merits of Partnership

A partnership firm has the following merits :

(i) Easy to form: A partnership is easy to form and inexpensive to establish.

(ii) Pooling of skills: Partners can provide skills and knowledge in different areas and can work towards greater profitability and growth of the firm.

(iii) Larger financial resources: The partnership firm can greatly increase the pool of capital available to the business. This helps in expanding business and earning higher profits.

(iv) Sharing of risks: The risks of running a business are shared by two or more persons. This emboldens partners to undertake riskier projects that are more profitable.

5.4.6 Limitations of Partnership

Limitations of partnership firm are as follows:

(i) Unlimited liability: Unless otherwise specified, all partners have unlimited liability. In case of two partners where one by virtue of mutual agreement has a limited liability, the other necessarily has unlimited liability. Usually, all partners individually have unlimited liability. But in special cases at least one partner has unlimited liability.

(ii) Uncertainty of continuity: The continuous existence of a partnership firm is uncertain. Retirement, insolvency, insanity, bankruptcy, death of any partner, terminates the partnership. Moreover, a partner can demand the dissolution of the firm, and thereby bring it to an end.

(iii) Non-transferability of ownership: A partner cannot transfer her/his share to another person if he so wishes. She/he can do so only with the consent of all other partners. This may make it difficult for her/him to withdraw from the arrangement.

(iv) Scope for conflicts: Partnerships are jointly owned and managed by all the partners. If partners adopt rigid attitudes, there is scope for disharmony and conflict, which may be to the detriment of the firm.

Partnerships are an ideal form of business organisation when mutual trust and complementary skills are present amongst partners. Wholesale merchants, chartered accountancy firms, and small and medium sized factories are commonly organised as partnerships.

5.4.7 Partnership Deed

As stated earlier, to enter into a partnership, partners have to agree to do so. The agreement may be written or oral. Although, the law permits oral agreements, it is advisable to have a written partnership agreement. This is to avoid disputes by clearly defining the terms of mutual agreement. This written agreement is referred to as the partnership deed.

The partnership deed normally contains the following clauses:

(i) Name of the firm;
(ii) Name and addresses of partners;
(iii) Nature of business;
(iv) Place of business;
(v) Capital contributed by each partner;
(vi) Profit sharing ratio;
(vii) Duties, powers and obligations of all partners;
(viii) Preparation of accounts and their auditing;
(ix) Whether interest is payable on capital and rate applicable;
(x) Whether interest is payable and drawings, and rate applicable;
(xi) Whether interest is payable on loan provided by partner, and rate applicable;
(xii) Whether salary is payable to partners;
(xiii) Method of solving disputes;
(xiv) Provisions regarding dissolution.

5.4.8 Registration of the Firm

Registration of a partnership firm is not compulsory. But an unregistered firm suffers from certain disabilities. These disabilities make it virtually compulsory for a firm to get registered. A partnership firm may be registered at any time that is, at the time of formation or at any time during its existence. A partnership firm desiring registration applies to the Registrar of Firms in prescribed form along with the registration fee. The application should state the following:

(i) Name of the firm;
(ii) The principal place of business of the firm;
(iii) The name of any other place where the firm is to carry on business;
(iv) Date of admission of the partners in the firms;
(v) Names and permanent addresses of the partners;
(vi) Duration of the firm.

The application must be signed by each partner. Changes in the above particulars have to be communicated to the Registrar. The certificate of registration is a reliable evidence and a conclusive proof of the existence of the firm.

Consequences of Non-Registration: An unregistered firm suffers from the following serious disabilities:

(i) A partner of an unregistered firm cannot file a suit against the firm or any other partner for enforcing his rights arising out of the contract;

(ii) An unregistered firm cannot file a suit against any third party for the recovery of claims;

(iii) Such a firm also cannot file a suit against any partner.

5.5 Cooperative Organisation

A cooperative form of business organisation is different from other forms of organisation. It is a voluntary association of persons for mutual benefit and its aims are accomplished through self help and collective effort. The main principle underlying a cooperative organisation is mutual help, i.e., each for one and all for each. A minimum of 10 people are required to form cooperative society. To be called a cooperative society it must be registered with the Registrar of Cooperative Societies under the Cooperative Societies Act. The capital of a cooperative society is raised from its members by way of share capital. It can also obtain additional resources by way of loans from the State and Central Cooperative Banks.

A cooperative society has much in common with partnership. Yet there are differences between the two types of organisation. In a partnership mutual benefit is restricted to partners only, but in a cooperative society it extends to its member as also the public. For example, in a consumer cooperative store or a cooperative credit society, the benefits are available to the members as well as the general public. Besides, partnership requires the existence of some business activity whereas a cooperative may be formed whenever individuals have common needs which are difficult to fulfil singlehanded. Also, registration is optional in the case of partnership but it is compulsory for a cooperative society.

5.5.1 Types of Cooperative Societies

Cooperative societies may be classified into different categories according to the nature of activities performed by them. The main types of cooperative societies are:

(i) Consumers' Cooperative Societies;

(ii) Producers' Cooperative Societies;

(iii) Cooperative Marketing Societies;

(iv) Cooperative Credit Societies;

(v) Cooperative Farming Societies;

(vi) Cooperative Housing Societies.

(i) Consumers' cooperative societies: These are organised by consumers to eliminate middlemen and to establish direct relations with the manufacturers or wholesalers. These societies are formed by consumers to ensure a steady supply of goods and services of high quality at reasonable prices. It purchases goods either from the manufacturers or the wholesalers for sale at reasonable price. The profit if any, is distributed among members as dividend in the ratio of capital contributed by

members and also as bonus in proportion to the purchases made by them.

(ii) Producers' cooperative societies: Such societies are formed to help the members in procuring inputs for production of goods or services. These societies generally, provide raw material, tools and equipment and other common facilities to its members. This helps them to concentrate their attention on production of goods. The society provides inputs to the members and takes over their output for sale to outsiders. The basis for distribution of bonus is the goods delivered for sale by each member.

(iii) Cooperative marketing societies: Such societies are voluntary associations of small producers, who find it difficult to individually sell their products at a profit. The main purpose of such a society is to ensure a steady and favourable market for the output of its members. The output is pooled together and sold at the best price. The sale proceeds are distributed in proportion to the contribution of the members to the pool. Marketing cooperatives eliminate middlemen and ensure honest trading practices in weighing, measuring and accounting.

(iv) Cooperative credit societies: Such societies are formed to provide financial help in the form of loans to members. The funds of these societies consist of share capital contributed by the members and the deposits made by them and outsiders. The funds are used in giving loans to needy members on easy terms. Thus, the members are protected from the exploitation of moneylenders, who charge very high rates of interest. Another important purpose of credit cooperatives is to encourage the habit of thrift among their members.

(v) Cooperative farming societies: In cooperative farming societies, small farmers join together and pool their resources for cultivating their land collectively. Their object is to achieve economies of large scale farming and maximising agricultural output. Such societies are particularly important in the case of countries such as India, where agriculture suffers from excessive sub-division and fragmentation of land. Cooperative farming makes it possible for members to use and irrigation facilities in order to achieve higher modern tools and equipments, good seeds, fertilisers production.

(vi) Cooperative housing societies: They are formed to provide residential accommodation to the members. They undertake the purchase and development of land and/or construction of houses/flats on the land. Some housing cooperatives provide their members with necessary loans at low rates of interest to build houses. These societies are gaining popularity in big cities.

5.6.2 Characteristics of Cooperative Organisation

The main characteris-tics of cooperative societies are :

(i) Voluntary association: In cooperatives, the membership is voluntary. Anybody having a common interest is free to join a cooperative society. The member can also leave the society anytime after giving proper notice.

(ii) Equal voting rights: In a cooperative society, the principle of one man one vote is adopted. A member has only one vote irrespective of the number of share(s) held by him. Thus, a cooperative society is run on democratic principles.

(iii) Separate legal entity: A cooperative society is required to be registered under the Cooperative Societies Act. Registration provides it a separate legal entity. Its existence is quite different from its members. The death, insolvency or lunacy of a member does not affect its existence. It can sue and be sued in its own name. It can make agreements as well as purchase and sell property in its own name.

(iv) Service motive: A cooperative society is based on the service motive of its members. Its main objective is to provide service to its members and not to organise profits. Earning profit is the most important objective of other forms of business organisation. It is not so in the case of cooperatives.

(v) Distribution of surplus: Out of the profits of the cooperative, members are paid dividend and bonus. The bonus is given according to the volume of business transacted by each member with the cooperative society. For example, in a consumer cooperative society, bonus is paid in proportion to the purchases made by members during a year. In a producers cooperative the value of goods delivered for sale forms the basis of distributing bonus.

5.6.3 Merits of Cooperative Organisation

The cooperative form of organisation offers the following advantages:

(i) Easy to form: A cooperative society is a voluntary association and may be formed with minimum of ten adult members. Its registration is very simple and can be done without much legal formalities.

(ii) Open membership: Membership in a cooperative organisation is open to all having a common interest. A person can become a member at any time she/he likes and can leave the society by returning her/his shares without affecting its continuity.

(iii) Democratic management: A cooperative society is managed in a democratic manner. It is based on the principle of one man one vote. All members have equal rights and can have a voice in its management.

(iv) Limited liability: The liability of members of a cooperative society is limited to the extent of capital contributed by them. They do not have to bear personal liability for the debts of the society.

(v) Stability: A cooperative society has a separate legal existence. It is not affected by the death, insolvency, lunacy or permanent

incapacity of any of its members. It has a fairly stable life and continues to exist for a long period.

(vi) Economical operations: The operation of a cooperative society is quite economical due to elimination of middlemen and the voluntary services provided by its members.

(vii) Government patronage: Government gives all kind of help to cooperatives, such as loans at lower rates of interest and relief in taxation.

(viii) Other benefits: Certain non-economic benefits are also derived by members through cooperatives. Credit cooperatives, for instance, promote habits of thrift and producers' cooperative encourage joint activity among members.

5.6.4 Limitations of Cooperative Organisations

As against the above mentioned advantages of cooperatives the following limitations and drawbacks of this form of organisation must also be noted:

(i) Limited capital: Cooperatives are usually at a disadvantage in raising capital because of the low rate of return on capital invested by members.

(ii) Inefficient management: The management of a cooperative society is generally, inefficient because the managing committee consists of part-time and inexperienced people. Qualified managers are not attracted towards a cooperative on account of its limited capacity to pay adequate remuneration.

(iii) Absence of motivation: A cooperative society is formed for mutual benefit of the group and the interest of individual members are not fully satisfied. There is no direct link between effort and reward. Hence, members are not inclined to put in their best efforts in a cooperative society.

(iv) Differences and factionalism among members: Once the initial enthusiasm about the cooperative ideal is exhausted, differences and group conflicts arise among members. Then, it becomes very difficult to get full cooperation of the members. The selfish motives of members begin to dominate and service motive is sometimes forgotten.

(v) Rigid rules and regulations: Excessive government regulation and control over cooperatives affect their functioning. For example, a cooperative society is required to get its accounts audited by the auditors of the cooperative department and to submit its accounts regularly to the Registrar. These regulations and controls may adversely affect the flexibility of operations and the efficiency of management in a cooperative society.

5.7 Company

The company form of organisation is considered to be most suitable for organising business activities on a large scale as it does not suffer from the limitations of capital and management of other forms of

organisation. The sole proprietorship, partnership and cooperative organisations are not capable of undertaking large scale activity due to lack of adequate capital and limited managerial abilities. In a company organisation those problems can be easily overcome. It has the advantage of attracting huge capital from the public due to the limited liability of members. With adequate capital it can also employ trained and experienced managers to run the business activities efficiently.

A company is defined as a voluntary association of persons having separate legal existence, perpetual succession and a common seal. As per the definition, there must be a group of persons who voluntarily agree to form a company. Once formed the company becomes a separate legal entity with a distinct name of its own. Its existence is not affected by change of members. It must have a seal to be imprinted on documents whenever required. The capital of a company consists of transferable shares, and members have limited liability.

5.7.1 Features of a Company

The following are the chief characteristics of the company form of organisation:

(i) Compulsory registration: A company has to be registered under the Companies Act, 1956. With out such registrations, no company can come into existence.

(ii) Distinct legal entity: A company is regarded as a legal entity separate from its members. Thus, a company can carry on business in its own name, enter into contracts, buy, sell and hold property, sue and be sued.

(iii) Artificial person: A company is the creation of law and has a distinct entity. It is, therefore, regarded as an artificial person. The business is run in the name of the company. But because it is an artificial person, its functions are performed by the elected representatives of members, known as directors.

(iv) Perpetual succession: A company has continuous existence, independent of its members. Death insolvency, or change of members does not affect the life of a company. The common saying in this regard is that *members may come, members may go but the company goes on for ever*. The life of the company can come to an end only through the prescribed legal procedure of winding up.

(v) Common seal: Since a company is an artificial person, it has no physical existence. The activities of the company are carried through a group of natural persons elected by its members (called directors). Every company must, therefore, have a common seal with its name engraved on it. Anyone acting on behalf of the company must use the common seal to bind the company. Thus, the common seal serves as the equivalent of the signature of an artificial person.

(vi) Limited liability: The liability of the members of a company is limited. It is limited to the extent of capital agreed to be contributed. Beyond that amount, the members cannot be personally held liable for payment of the company's debts.

(vii) Transferability of shares: The capital of a company is divided into parts called shares. Normally, the shares of a company are freely transferable by its members. However, transferability is restricted in the case of private company, although it is permitted.

5.7.2 Merits of a Company

The important advantages of a company organisation are as follows:

(i) Collection of huge financial resources: The biggest advantage of a company organisation is that it has the ability to collect large amounts of funds. This is because a company can raise capital by issuing shares to a large number of persons. Shares of small value can be subscribed even by people with small savings. Availability of necessary funds makes it possible for a company to undertake business activities on a large scale.

(ii) Limited liability: Another advantage of the company form of organisation is the limited liability of members. With the liability of members limited to the value of their shares, a company is able to attract many people to invest in shares. It is thus, in a position to undertake business ventures involving risks.

(iii) Free transferability of shares: A company permits its members to transfer their shares. Free transferability of shares provides liquidity to the member's investment. Thus, if a member needs cash he can sell his shares. Or, she/he can use the same amount to buy shares of another profitable company. It enables profitable companies to attract funds away from the less profitable ones.

(iv) Durability and stability: A company is the only form of organisation, which enjoys continuous existence and stability. The funds in vested in a company by the shareholders cannot be withdrawn until it is wound up. Also, change in the company's membership does not affect its life. As a result of this, a company undertakes projects of long duration and attracts people to invest in the business of the company.

(v) Growth and expansion: With the large resources at its command, a company can organise business on a large scale. Once the business is started on a large scale it gives the company strength to grow and expand. This is because of high profits which accrue from the economies of large scale organisation and production.

(vi) Efficient management: Since a company undertakes large scale activities, it requires the services of expert professional managers. Competent managers can be hired by a company because it commands large financial resources. Thus, efficient management is more easily ensured in a company organisation.

(vii) Public confidence: A company enjoys great confidence and trust of the general people. Companies have to disclose the results of their activities and financial position in the annual reports. These reports are available to the public. It is on the basis of the annual reports and other information that investment is made in companies.

(viii) Social benefits: Apart from the benefits mentioned above a company organisation also offers the following social benefits:

(a) **Democratisation of management:** In the company form of organisation, management of business is entrusted to the elected representatives of shareholders, that is the directors. As a result of democratic management the business of a company is more likely to run in the best interest of the majority of shareholders.

Reliance Emerges as No. 1 Amongst All Indian Business Houses

The Reliance Group: It has emerged as No. 1 in market capitalisation, net worth, assets and profits amongst all Indian Business Houses at the end of the millennium according to a study of performances of Indian Business Houses. The study data for other groups have been sourced from the Centre for Monitoring Indian Economy (CMIE) database.

Largest market capitalisation: The market capitalisation of the Reliance Group, which represents the wealth of its shareholders, stands at Rs 47652 crore. This is Rs 5939 crore higher as compared to the next group on the list.

Largest wealth distributor: Reliance Group is also responsible for creating the most wealth for its public shareholders. Reliance has a large base of 5 million investors, and has shared the wealth liberally with its public shareholders. At the close of the millennium the wealth created by the Reliance Group for the public at large, exceeds Rs 33000 crore. Groups and companies, which have their market caps surging in the recent past, have most of their equity concentrated in the hands of a few promoting shareholders. On the other hand, Reliance Group has continued to lead in its effort of democratisation of capital.

Largest net worth: Reliance leads the Indian Business Houses in terms of net worth at the end of the millennium. Its present net worth stands at Rs 19884 crore, which exceeds that of the next group by Rs 3190 crore. Reliance Group's net worth represents more than 30 per cent of the collective net worth of the top 10 net worth groups.

Largest assets: Reliance Group has the largest assets among all the Indian Business Houses. Its total assets are over Rs 55000 crore. Reliance Group's gross fixed assets and net fixed assets at Rs 39533 crore and Rs 31582 crore are also the largest among all Indian Business Houses at the end of the millennium.

Source : Website of Reliance Industries

(b) **Dispersal of ownership:** Since a large number of persons are associated with a company as members, its ownership is widely held. Thus, the benefits of the company's operations are distributed among a large section of people.

(c) **Assumption of social responsibilities:** Large companies often undertake and contribute to social welfare activities by making donations to schools and colleges, developing rural areas, running healthcare institutions, and so on.

5.7.3 Limitations of Company Organisation

The following are the chief limitations of a company organisation:

(i) Lengthy and expensive legal procedure: The registration of a company is a longdrawn process. A number of documents are to be prepared and filed. For preparing documents, experts are to be hired who charge heavy fees. Besides, registration fees have also to be paid to the Registrar of Companies.

(ii) Excessive government regulations: A company is subject to

Reliance Group

Highest profits: In the year 1998-99, Reliance Group has recorded an operating profit of Rs1978 crore, which is more by Rs 571 crore from the next group. This is the highest operating profit among all the Indian Business Houses for the year 1998-99. Reliance's net profit for the year 1998-99 stands at Rs 1792 crore, which is the highest net profit recorded by an Indian Business House for the same period. The Reliance Group net profit is around Rs 250 crore higher than that of the nearest group. For the half-year ended September 1999, Reliance has recorded a net profit of Rs 1184 crore, which makes it the No. 1 group in terms of half-yearly net profit at the close of the millennium.

Major growth in post liberalisation era: The Reliance Group has been able to capitalise on the opportunities thrown up by the globalisation of the Indian economy, starting from mid 1991 onwards. The Reliance Group has successfully met the challenges of liberalisation and achieved a major part of its growth in the post liberalisation era. The group's sales has recorded a compounded annual growth rate of 26 per cent, growing from just below Rs 3000 crore in 1991-92 to over Rs 15000 crore in 1998-99. The group net profit has grown even faster at a compounded annual rate of around 41 per cent per annum, from Rs 163 crore to Rs 1792 crore over the same period. Similarly, the Reliance Group's net worth has increased by over 10 times to over 19000 crore, and the group's total assets have grown by over 11 times to more than Rs 55000 crore between 1992 and end 1999. This growth has been achieved despite intense competition from global majors, regional economic crisis, downturn in domestic economy, and a sharp cut in import duties on Reliance's major products from 110 per cent in 1993 to 30 per cent in 1999.

Source : Website of Reliance Industries

government regulations at every stage of its working. A company has to file regular returns and statements of its activities with the Registrar. There is a penalty for non-compliance of the legal requirements. Filing returns and reports involving considerable time and money is the responsibility of the company. All this reduces flexibility in operations.

(iii) Lack of incentive: The company is not managed by shareholders i.e., owners but by directors and other paid officials. Officials do not have investment in the company and also do not bear the risks. As such, they may not be as much motivated to safeguard the interests of the company as the shareholders i.e., owners would have been.

(iv) Delay in decision-making and action: In large companies, decision-making and its implementation is a time consuming process. This is obviously because individual managers are unable to take decisions on their own. They may have to consult others which may take a lot of time. Similarly, after decisions are taken, they have to be communicated to people working at various levels of the organisation. This further delays the implementation of already delayed decisions.

(v) Conflict of interest: A company generally, has many groups involved in its operations. So long as the interests of these groups do not clash with each other they work for the good of the organisation. But sometimes, individual and group interests become difficult to reconcile. For instance, the sales manager may be interested in the quality of products to satisfy customers and increase sales, but the production manager may be more concerned with maximum production without regard to the product quality. In such a situation, the business is bound to suffer in course of time unless there is a reconciliation of the conflicting viewpoints of the two managers.

(vi) Oligarchic management: The company management may seem to be fully democratic, but in actual practice, it is the worst form of oligarchy i.e., control by a small group of persons. People who are once elected as directors of a company adopt various means to get themselves re-elected over and again. Such individuals often exploit the company for personal interests rather than working in the interest of shareholders.

(vii) Speculation: In speculation, profits are sought to be made by manipulating price of shares without actually holding shares. A company organisation provides scope for speculation in shares by the directors. Because directors have knowledge of all information about the functioning of the company, they can use it to their personal advantage. For example, directors may sell or buy shares knowing that prices will decline or go up because of low or high profits. As a result of this, innocent shareholders may suffer loss.

(viii) Growth of monopolistic tendencies: A company because of its large size has the tendency to grow into monopoly so as to eliminate competition, control the market and charge unreasonable prices to maximise profits. The larger the size of a company, the greater is the possibility of it acquiring monopoly power.

(ix) Influence government decisions: Big companies are generally, in a position to influence government officials to make decision in their favour. This is because such companies have large financial resources and are in a position to bribe even high officials.

From the preceding discussion it is clear that the company form of organisation is best suited to those lines of business activity which are to be organised on a large scale, require heavy investment of capital with limited liability of members. That is why enterprises producing steel, automobiles, computers and other high technology products are generally, organised as companies.

5.7.4 Types of Companies

Companies may be classified as private company and public company.

(i) Private company: A private company is one which:

(a) has a minimum of 2 and a maximum of 50 members excluding past and present employees;

(b) restricts the right of members to transfer its shares;

(c) does not invite the public to subscribe to its shares, or debentures;

(d) does not invite the public to subscribe to its deposits;

(e) the minimum paid up capital is one lakh rupees (this amount is subject to change from time to time).

All these restrictions must be continuously observed by a company to be called a private company. Such a company can manage its affairs with a minimum of two directors only. It must include the word *private limited* as a part of its name.

A private company is an ideal form of organisation for those who wish to run a business without associating a large number of members and at the same time deriving the benefit of limited liability. This form of organisation enables a small group of persons to control the management of the company without the risk of displacement by any large shareholding group.

(ii) Public company: A public company is one which:

(a) has a minimum of 7 members and no limit regarding the number of members;

(b) does not restrict the right of its members to transfer its shares;

(c) is not prohibited from inviting the general public to subscribe to its shares and debentures;

(d) is not prohibited from inviting the general public to subscribe to its public deposits;

(e) has a minimum paid up capital of five lakh rupees (this amount is subject to change from time to time);

Concept of Subsidiary Company

A company is a subsidiary of another if:
the other company controls the composition of its Board of Directors, or
the other company holds more than 50 per cent of its equity share capital or
it is a subsidiary of a third company which itself is a subsidiary of the controlling company. For example, if company B is the subsidiary of company A, and company C is the subsidiary of company B, then company C shall be the subsidiary of company A.
The equity share holding pattern of XYZ Private Ltd. is as follows:
Fifty one per cent of shares held by PQR Ltd.
Forty nine per cent of shares held by the public.

Thus, XYZ Private Ltd. is infact a public company in accordance with requirement (f) above.

(f) is a private company, which is a subsidiary of a public company, it follows, therefore, that a private company, which is a subsidiary of a public company, will be treated as public company.

5.7.5 Privileges of Private Company

A private company is entitled to certain privileges. A few of the important ones are as follows:

(i) Number of members: A private company can be formed with only two

Distinction Between Private and Public Company

Characteristic	*Private Company*	*Public Company*
Number of members	Minimum 2, maximum 50 (excluding past and present employees)	Minimum 7, maximum no limit
Number of directors	Minimum 2	Minimum 3
Invitation for public subscription to shares debenture and deposits	Public offer not permitted	Invitation to public permitted
Transfer of shares	Transfer of shares restricted	Free transfer of shares allowed
Index of members	Not compulsory	Compulsory
Legal formalities	Exempt from many legal formalities regarding prospectus, certificate of commencement of business, quorum, etc.	Not exempt from such legal formalities.
Minimum paid up capital	Rs 1 lakh	Rs 5Lakh

members, whereas at least seven members are required to form a public company. This makes its formation easier.

(ii) Number of directors: A private company needs to have only two directors while a public company must have three directors.

(iii) Index of members: A private company does not need to keep an index of its members which is absolutely necessary for a public company

(iv) Loans to directors: A private company is not required to take permission from the government while giving loans to directors, as is required in case of a public company.

(v) Legal formalities: A private company is exempt from certain legal formalities like issue of prospectus, getting certificate of commencement of business, minimum subscription, quorum etc. which are necessary in case of a public company.

8.7.6 Deemed Public Company

Prior to an amendment in the law in 2000, there was a category of companies referred to as deemed

A Survey, the Only One of Its Kind, Ranks India's Largest Private Companies in the Private Sector with Some Surprising Results

Today over a quarter million companies are public limited. Yet some of the world's largest corporations have remained unlisted for centuries. The $49.4 billion Cargill Inc. for example, funded in 1865, is the largest private corporation in the US. So is the $ 20 billion consulting firm Pricewaterhouse Coopers, the $15.3 billion food processing major Mars, the $15.1 billion construction company Bechtel Group and the $5.1 billion apparel company Levi Strauss.

Some claim that there is not much to debate. Listed companies have greater access to capital (and, therefore, superior chances of growing), they are better managed, thanks to considerably higher levels of corporate governance, and they are, perhaps, ennobled by the fact that they share their wealth with others. As evidence, the proponents of widely-held companies point to the fact that the world's largest corporations are always public companies.

The compulsion of not listing or not going public also remain strong. Many promoters are not sure investors would adequately value the champion of the unlisted, Adi Godrej: It makes no sense listing companies where the companies do not require additional funds for expansion, or where the company may have significant assets other than (those required for) their normal business, which the stock market may not sufficiently value. His companies Godrej Appliance (Rank 17; Revenues: Rs 810.2 crore), Godrej Appliances (Rank 20; Rs 731.1 crore) and Godrej Agrovet (Rank 62; Rs 336.2 crore) are among the list of top 100 unlisted companies in India.

Source : Business World

Nirma Consumer Care

For the FMCG major Nirma Consumer Care, the rationale for not going public is not ease of operations, but the ability to bear risk. The group's present, Nirma, set up by chairman Karsanbhai Patel in 1969, went public as late as 1994 (the Patels still own 82 per cent of the equity). But, Nirma's Rs 1,552-crore (Rank 7) subsidiary Nirma Consumer Care, which owns the distribution network, is still unlisted. Nirmas's reasons were: "We decide it (going public) on the basis of requirement of capital and risk bearing capacity. When the risk is so big that one does not want to bear it on his own, it's better to go public."

Source : Business World

public companies. Such companies were registered as private companies. Yet they were considered as public companies by the existing law. Thus, a private company automatically became a public company if:

(i) its shareholding pattern involved members of the public;

(ii) its turnover was high enough to warrant public interest;

(iii) it employed public money.

A private company became a public company (known as a deemed public company):

(a) Where 25 per cent or more of the paid-up share capital of the private company was held by a public company (or a deemed public company).

(b) Where the private company held 25 per cent or more of paid up share capital of a public company.

The Top 25 Private Companies in the Private Sector in India

1. Tata Sons
2. Hyundai Motor India
3. Jet Airways (India)
4. Citi Bank NA
5. Gitanjali Gems
6. LG Electronic India
7. Nirma Consumer Care
8. Gujarat Powergen Energy Corp
9. Bennett, Coleman and Company
10. Kundan Rice Mills
11. Tractors and Farm Equipment
12. Samsung India Electronic
13. Bharat Aluminium Company
14. Cargill India
15. Yamaha Motor Escorts
16. Hero Cycles
17. Godrej and Boyce Mfg. Co.
18. Redington (India)
19. Abn-Amro Bank N.V.
20. Godrej Appliances
21. Allanasons
22. Concorde Motors
23. Automotive Manufactures
24. Parle Products
25. Deutsche Bank

Source : Business World

(c) Where the average annual turnover of the private company for 3 consecutive financial years was Rs 25 crore.

(d) Where the private company invited deposits from the public.

A deemed public company was a special type of public company. It was not treated as a public company in all respects. It could retain some features of a private company. However, in the present legal structure deemed public companies do not exist. Following the amendment, a private company does not automatically become a public company on account of shareholding pattern or turnover.

5.8 Choice of Form of Business Enterprises

Having discussed the characteristics, merits and limitations of the various forms of organisation (sole proprietorship, joint Hindu family business, partnership, cooperative and company organisation) we may consider how to select the most suitable form of organisation for a business venture. Choice of a suitable form of organisation is important because the success and growth of a business depends a great deal on it. The form of organisation determines the availability of finance, risk associated with business, division of profit, owners' control, stability and durability of business, and so on. Since business and entrepreneurial objectives vary, no single form of organisation can be considered as the best for all kind of business. The selection of a suitable form of organisation is generally, made after careful consideration of the following factors:

(i) Nature of business: This kind of business activity has a bearing on the form of ownership. If the work requires personal attention such as hair dressing saloons and customised tailoring units it is generally, set up as a sole proprietorship. Units engaged in large scale manufacturing, chain stores, and large departmental stores requiring heavy investment are more likely to be companies. Organisations engaged in pursuing welfare activities for their members are usually, cooperative societies. Firms rendering professional services, such as chartered accountants, lawyers and architects are either sole proprietorships or partnerships. The most large retailers and wholesalers are partnerships, and small retailers normally sole traders. Likewise, family businesses are likely to be HUFs or private companies.

(ii) Financial requirements for starting and expanding business: Enterprises requiring heavy investment, such as the airlines, chemical plants auto manufacturing units need to be organised and are formed as companies. Similarly, the future requirements of growth and expansion is another relevant factor. The company form of organisation offers the maximum scope for further growth and expansion. On the other hand, where the funds required are

small and there are no immediate plans of expansion, a proprietorship, or partnership is a better choice.

(iii) Degree of control desired: A person, who desires full and exclusive control over business prefers proprietorship rather than partnership or company because control has to be shared in these cases.

(iv) Degree of risk involved: The degree of risk and the willingness of owners to bear it, is an important consideration in the choice of form of organisation where the project is risky or where it requires large financial resources, due to unlimited personal liability the promoter may not like to organise as a proprietor or a partnership. He may opt for a company form as there is diffusion of risk in a public company.

(v) Freedom from government regulations: Sole proprietorships and partnerships continue to be popular forms of organisation, despite the unlimited liability factor associated with them. One major reason for their popularity is the relative freedom they enjoy from government control. Companies and cooperative on the other hand are subject to many government regulations, and this involves both time and money. This lack of freedom from government regulation is one of the deciding factors in the formation of a company, for many businesspersons.

(vi) Duration of business venture: Temporary, short term and *ad hoc* ventures are generally, organised as proprietorships or partnerships because they are easy to form and dissolve. But, where the business interest is permanent or long term, the company with its feature of perpetual succession is the most appropriate.

Ultimately, it needs to be emphasised that the above factors are inter-related and influence each other. For instance, the financial requirements of a business depend upon the nature of business as well as the scale of operations. The establishment of an industrial enterprise (production of toys, for example) on a large scale would need greater outlay of capital, than a small enterprise for the same purpose. Similarly, the degree of risk and liability will depend both on the amount invested and the nature of demand for the products of the enterprise. Thus, for a small enterprise (say, a workshop or a grocery shop) the risk will be limited and so will be the owner's liability, even if personal assets may be used to discharge business debts. Control and sharing of profit are interconnected and both are related to the risk and liability. If, the risk and liability are not heavy, the entrepreneur would not like to give up control and share profits with others.

A few examples to illustrate the suitability of different form of business enterprise are given below:

(i) Proprietorships: Local grocery stores, stationery shops, bakeries, customised tailoring units, hair cutting saloons, small factories,

hawkers, small retail outlets, dry cleaners and other enterprises requiring limited capital, low risks and the use of personal knowledge.

(ii) Partnerships: Professional services, such as chartered accountancy firms, architect firms, law firms etc., wholesalers, restaurants, medium sized trading concerns, and enterprises requiring the involvement of additional persons.

(iii) Private companies: Medium sized manufacturing units, hotels, relatively large trading concerns, and any business ventures requiring greater capital outlay and managerial requirements than a partnership.

(iv) Public companies : Airlines, large hotels, large trading concerns, departmental stores, chain stores, shopping malls, auto-manufacturers, iron and steel industrial units and any business involving heavy financial outlay, risk, and managerial expertise.

5.9 Factors to be Considered for Starting a Business

Starting a business is a difficult task. It involves financial commitment, risk taking and lots of effort. Many factors are to be considered keeping in view the three broad objectives of a new venture: creation, survival, and profitability. To start a business, some of the key factors are the following:

(i) Market analysis: The entrepreneur should conduct a market analysis to ascertain that the demand for the product or service is substantial and growing. However, at times the demand may not be expressed but latent. In any case, the selected venture should have the potential for large sales volumes and high growth rate.

(ii) Development and production analysis: Another key consideration relates to the research, development and production of the goods or service. A detailed outline of each of the stages involved in the accomplishment of the core function is constructed. Details of the time and money allocated to each stage are worked out. Besides, a detailed resource requirement is done to outline the physical, financial, human technological and organisational resources that will be required.

(iii) Financial analysis: A detailed list of all physical assets needed, and a statement of organisational costs including legal construction engineering, etc. should be prepared. The person intending to start a business must have a fairly accurate idea about the amount of funds required for the project. Either he should possess the money or be in a position to mobilise it. Adequate finance at reasonable cost and time is an important ingredient for business success.

(iv) Location of business: This is an important decision because it affects several components of cost, especially, for manufacturing units. Therefore, computer and other professionals in urban and metros have recently adopted the home-office norm, referred to as SOHO (small office

home office), as a cost saving measure. But, where plant and machinery has to be installed, and transportation charges to be incurred on both raw materials and finished goods, the decision have to be taken with great care so as to minimise costs.

Units located in urban commercial centres and industrial areas involve heavy initial expenditure. But, they have the advantage of developed infrastructure, such as telecommunications, transport and electricity. On the other hand, industries set up in backward or remote areas implies much cheaper set up costs. But, transportation costs on finished goods and raw materials which have to be incurred prove to be very disadvantageous.

(v) Personal characteristics: A crucial factor in this decision is the mind set of the person intending to start business. Only one with entrepreneurial instincts and risk taking ability should enter into business. The extra conservative, extremely careful and risk averse individuals should not undertake business activities.

(vi) Government policy: A careful study should be done to analyse whether any government actions in the past have contributed to the development of the particular product/sector selected and also the current government stand and position on it. A liberal import regime, strict health and safety standards and a heavy tax structure will be detrimental to the business prospects of the product under these conditions. The demand as recorded in the past will no longer represent potential demand. It is a warning bell for the prospective investor. On the other hand, the government may be promoting a particular sector/product with tax concessions and soft loans. Thus, this exogenous factor of government policy is an important consideration.

5.10 Scope for Setting Up Small Business

Despite the growth of large scale industry, small business has survived and progressed because it has its own specialised areas of operating. The following factors make way for the scope of small business enterprises:

(i) Limited resources: Individuals with entrepreneurial spirit but with limited economic means and resources always have before them the option of starting a small business. Furthermore, a small business can be established without much legal procedures.

(ii) Flexibility: Small firms are able to react more quickly to changes in the environment. They are usually, owner-operated, and this allows them to try new products, new methods, and new ideas without requiring lengthy and elaborate approval procedures.

(iii) Personal touch: Small enterprises are more likely to succeed in areas requiring *personal touch* in handling customers. Fine restaurants, high-style boutiques, hair cutting

saloons and custom jewellery stores are examples, where the personal touch is needed and most of these continue to be small firms.

(iv) Limited demand: When the market for any goods and services is limited, a small business may be able to survive on the demand generated by the limited market. Big companies may not find it worthwhile to invest in such projects because the demand is not sufficient to make mass produc-tion worthwhile. Some markets would not be served were it not for small business. Examples are antique dealers, and art galleries for budding artists with limited means.

(v) Supplying the needs of large corporations: Small businesses play an important role in the operations of large corporations, acting as distributors, servicing agents, and vendors. In India, a lot of successful companies are outsourcing their requirement from small business vendors, by exercising strict quality control standards over them.

(vi) Individual temperament: Small business is a way of life for people who can't stand the boss. Individuals sometimes temperamentally are too independent, and would be unhappy to take orders from others. For such persons, the option of starting their own business always exists.

(vii) Inherent disadvantages of large business: Furthermore, the scope of small business emanates from the inherent weaknesses of large corporations such as:

(a) The potential for too much concentration of economic power;

(b) The potential for reduced management efficiency;

(c) The lack of personal touch between managers and the subordinates leading to sour industrial relations i.e., labour management disputes.

Small business in India includes the following:

(i) Small Scale Industries (SSIs) i.e., Units where investment in plant and machinery is upto Rs 1 crore;

(ii) Tiny units i.e., Units where investment in plant and machinery is Rs 25 lakh. (industry includes industry and industry related services);

(iii) Small business enterprises are prevalent in all parts of the world. But in a developing country such as ours they occupy a place of special significance. They have an important role in India's industrial development;

(iv) They are labour intensive and have great employment generation potential;

(v) They promote regional development by using local resources and personnel;

(vi) They contribute to an equitable distribution of national income.

For these reasons, steps for the development of small scale and cottage industries have been initiated by the government right since independence. Successive policy guidelines (Industrial Policy Resolutions) as well as 5 Year Plan documents have

Contribution of Small Scale Industries (SSIs) in India

Forty per cent of country's industrial output;

Thirty per cent of country's exports;

Eighty per cent of employment in the industrial sector.

Source : Business World

attempted to promote and assist such industries. The important measures adopted are the following:

(i) Reservation of 800 items for exclusive production by the SSIs.

(ii) Liberalised credit norms and procedures for borrowings from commercial banks.

(iii) Price and purchase preference to products manufactured by SSIs in government purchase programme.

(iv) Excise duty exemption upto Rs 1 crore of production case of SSI units.

(v) Permitted equity participation in the SSI by other industrial unit upto 24 per cent of total shareholding. Large industries can now lend support to smaller business.

(vi) Permitted a new legal form of business organisation namely limited partnership. In a limited partnership, the liability of at least 1 partner is unlimited where as other partners have limited liability. Thus, small business can now attract capital from friends and relatives, who will now be sure that their liability in the venture is limited

(vii) The National Equity Fund (NEF) scheme provides equity type support to entrepreneurs for setting up new projects or expansion in tiny/small sector. This is in the form of a soft loan, no interest charged except for service charge of 1 per cent per annum.

(viii) SIDBI has formulated a Credit Guarantee Fund Trust (CGFT) for small industries for guaranteeing the loans and advances upto Rs 10 lakh, without collaterals or third party guarantees.

(ix) SIDBI has formulated Micro Credit Schemes to provide loan assistance to Self Help Groups such as :

(a) Societies registered under Societies Act;

(b) Trusts registered under Public Trust Act;

(c) Section 25 Companies;

(d) Institutions and Finance Companies focusing on banking with the poor;

(e) Cooperatives and Specialised Cooperatives such as Mutually Aided Cooperatives.

What SSIs Need to Comply With

Statue	*Nature of Compliance*
The Employees' State Insurance Act	Remittance contribution
The Employees' State Insurance Act	Declaration form
The Employees' Provident Fund	Remittance of PF contributions
The Employees' Provident Fund and MP Acts	Return of employees
Member's Ledger	To be posted and kept (to be sent to RPFC by the year end)
The Apprentices Act	Bill for reimbursement
The Factories Act	Notice of accident
The Factories Act	Notice of dangerous occurrence
The Workmen's Compensation Act	Report of fatal accidents
N.A.	Annual return

Source : Business World

The Woes of the Small Entrepreneur

The small sector is wilting under the pressure of over-regulation. A number of factors, including over-regulation, archaic laws and the government's reservation policy, have adversely impacted the small scale industry (SSI). Small sector units are on the verge of closure due to the fast-changing business environment. A recent study by the Confederation of Indian Industry (CII) pinpoints the problems and sets an agenda to ensure the survival of the SSIs.

While the government is busy dismantling the licensing and regulatory raj for big business, the tiny sector is still plagued by over-regulation and rampant corruption. For example, a small entrepreneur needs as many as 24 clearances (from registration to sanitation) from various departments before he can set up a new unit. There are around 15 different legislations (The Factories Act, Payment of Wages Act, The Employees State Insurance Act) that govern his day-to-day working. Worse, during a year, his factory may be visited by nearly 40 inspectors from various departments under different ministries (Planning and Statistics, Finance, Health and Family Welfare). The CII study recommends that instead of a multiplicity of laws, a single law (Single Small Business Establishment Act) should govern small units.

The Need to be More Competitive

SSIs should focus on comparative advantage and sub-contracting. The World Trade Organisation (WTO) rules have far-reaching implications for the Indian SSIs. This is particular so for units in areas like toys, where Chinese goods are dominating the market. Three key areas of impact include the removal of quantitative restrictions of imports (by 2003, most physical control will go), the consistent fall in import duties (by 2005, the duty ceiling on finished goods will be 40 per cent and 25 per cent for intermediates) and the provision of actionable subsidies pertaining to import (importing nations can impose additional duties on Indian exports). Therefore, the SSI needs to learn to survive without subsidies and face competition from low-cost producers from countries like China without the protection of high tariff barriers. The CII study recommends the SSIs reposition themselves in strategic areas where India has comparative advantages, develop India as a subcontracting base and improve quality through technological upgradation.

SUMMARY

Business undertaking: This is an organisation through which business activities are carried out. For the private sector in India the forms of business organisations/enterprises are: sole proprietorship, joint Hindu family business; partnership; cooperative society; and company.

Sole proprietorship: This is a form of business that is owned, managed and controlled by an individual. The sole proprietor alone is entitled to the profits and has to bear the losses. Her/his liability is unlimited. This form of organisation has the advantages of: ease of formation and closure, simplicity of operation and flexibility of management, undivided claim on profits and the benefits of small scale operations. However, it suffers from the limitations of management skills, capital, unlimited liability and lack of continuity.

Joint Hindu family business: This refers to a business organisation owned by the members of a joint Hindu family. It is governed by the Hindu law. Only male members, restricted to three successive generation can become its members. Thus, membership is not created by an agreement but is determined by birth. The oldest member is called *Karta* and is responsible for managing the business. Except for him, the liability of other members is limited.

Partnership: This form of organisation is an association of persons who pool their financial resources and managerial abilities to share the profits of a business in an agreed ratio. The partnership organisation is formed on the basis

of agreement between a minimum of 2 persons to carry on a business. A maximum of 20 persons can be members in partnership. In a partnership organisation, each partner is a principal and that agent of other partners and can bind the firm by his acts. The liability of partners is unlimited. Registration of a partnership firm is not compulsory. But when so desired it may be registered with the Registrar of Firms under the Indian Partnership Act.

Types of partners: Various types of partners are found in partnership firms: active and sleeping partners (full-fledged partners), nominal partners and partners by holding out. A minor can also be admitted into the benefits of partnership. These partners may be found in all the three types of partnership organisation namely, partnership at will, particular partnership and partnership for a fixed duration.

A partnership organisation offers several advantages, like ease of formation, pooling of financial and managerial resources, balanced business decisions and sharing of risks. However, it also suffers from limitations, like uncertainty of existence, risks of implied authority, risk of disharmony, difficulty in withdrawal from the firm, lack of institutional confidence and difficulties of expansion and modernisation.

Cooperative: This form of organisation is established by a group of persons who voluntarily come together for mutual benefit. The aims of a cooperative society are accomplished through self-help and collective effort. The principle of one-man-one-vote governs the functioning of a cooperative. The capital of a cooperative society is raised by issue of shares to the members, and as loans from the State and Central Cooperative Banks. Out of the profits, the members are paid dividend and bonus according to the business transacted by them with the cooperative society. Unlike, sole proprietorship and partnership, a cooperative organisation has a separate legal entity. It can be registered with the Registrar of Cooperative Societies.

Cooperative societies: The main types are — consumers cooperatives; producers cooperatives; cooperative credit societies; marketing cooperatives; cooperative farming societies; and cooperative housing societies.

A Cooperative organisation has advantages, like ease of form action, open membership, democratic management, limited liability, government patronage, and other non-economic benefits. A cooperative organisation has also certain limitations, like limited capital, inefficient management, absence of motivation, differences among members, rigid government rules and regulations.

Company: This form of organisation may be defined as an artificial person created by law, having a separate legal entity, perpetual succession, a common seal and the capital fund consisting of transferable shares, with limited liability. These features of a company organisation permit it to conduct business on a

large scale and also overcome the limitations of capital and management of sole proprietorship, partnership and cooperatives. In spite of these features and advantages, a company organisation has several limitations such as lengthy and expensive legal procedure, excessive government regulations, lack of incentive of managers, delay in decision-making and action, conflict of interest, oligarchic management, speculation, growth of monopolistic tendencies and influencing government decision for narrow interests.

Private company: This company is one which restricts its membership to a maximum of 50; is prohibited from inviting the public to subscribe to its capital; and restricts transferability of its shares. The private company enables a small group of persons to control the management of the company without the risk of displacement by a large shareholding group.

Public company: This company is one which does not have any of the restrictions that apply to a private company. It is an ideal form of organisation for starting business on a large scale.

A private company enjoys several privileges as compared with a public company. It can be formed with only two members, need to have only 2 Directors, and is not required to maintain an index of members Further, it is not required to get the approval of government for granting loans to Directors. It is also exempt from certain legal formalities.

The main purpose of discussing the features, merits and limitations of the various forms of private enterprises is to select a form of organisation that can effectively meet the business and entrepreneurial objectives. Since, business and entrepreneurial objectives vary, no single form of organisation can be considered as the best for all kinds of business.

Choice of form of business enterprise: However, the selection of a suitable form of organisation can be made after carefully considering these factors: nature of business, scale of operations, financial requirements, degree of direct control desired by owners, degree of risk and liability, division of profit, flexibility of operations, stability of business, legal procedure. Because these factors are interconnected, their collective effect should govern the final choice.

Factors to be considered for starting a business: To start a business, the key factors are market analysis, development and production analysis, financial analysis, location of business, personal characteristics and government policy.

Small business: The scope for setting up small business despite the growth of large scale industries still exists. There are certain factors which are responsible for the scope of small business enterprises. These are limited resources, flexibility, personal touch, limited demand, supplying the needs of large corporations, individual temperament and inherent disadvantages of large business.

Small business in India include small scale industries and tiny units. Small business enterprises have an important role in India's industrial development. They are labour intensive, promote regional development and contribute to equitable distribution of income. Industrial Policy Resolutions and 5 Year Plan documents have attempted to promote the small scale sector.

EXERCISES

Short Answer Type Questions

1. Discuss whether the sole proprietorship involves a lengthy and expensive procedure for its formation.
2. Explain whether the liability of a sole proprietor is limited to the extent of his share in business.
3. Only the *Karta* has unlimited liability in a HUF. Explain.
4. Define partnership. State its important features.
5. Outline the procedure for registration of partnership.
6. Enumerate the various types of cooperative societies.
7. When is it appropriate to form a sole proprietorship?
8. Give any three limitations of the sole proprietorship as a form of organisation.
9. Can a partnership firm have a minor partner?
10. A cooperative society is not set up for making profits, discuss.
11. Explain how a cooperative is a democratic institution.
12. A company form of organisation is popular because its members have limited liability. Explain why is the company form of organisation is a portion to undertake huge and risked projects?
13. Explain how the company is an artificial person.
14. Discuss whether a company's existence is affected by the death of a member.
15. Explain the concept and external of deemed public companies.
16. Distinguish between partnership and a private company.

Long Answer Questions

1. What do you understand by sole proprietorship? Outline its features. Explain its merits and limitations?
2. "One man control is best in the world if that one man is big enough to manage everything." Explain the statement.
3. Explain the features of a joint Hindu family business.
4. Discuss the merits and limitations of partnership.
5. Describe the various kinds of partners in a partnership firm and discuss their rights and obligations.

6. Define partnership deed. Discuss its main contents.
7. Define cooperative organisation. Explain its main characteristics.
8. Discuss the advantages and limitation of cooperative organisation. Name activities which can be suitably undertaken by cooperative societies.
9. What is a company? What are its characteristics? Explain its advantages and limitations.
10. List the factors that help in choosing a suitable form of organisation.
11. What are the factors to be considered while starting a business? Discuss.
12. Do you think small business units can survive in a competitive market? Explain the scope of small business enterprises in the light of their potential advantages.

Project Work

1. Study the profile of a sole trader commenting on the nature and working of business.
2. Study the working of a partnership firm. Interview each partner and find out how they overcome the difficulties they face in business operations. Some of the questions you can ask are :
   - Do they take decisions jointly?
   - Have they demarcated their areas of operation?
   - How are profits, expenses and drawings accounted for?
   - How do they reconcile their differences?
3. Study the problems faced by any small business unit, regarding finance, marketing, etc.

PART II

Corporate Organisation Finance and Trade

CHAPTER 6

Sectoral Organisation of Business

LEARNING OBJECTIVES

After studying this chapter, you should be able to :

- identify the various forms of public sector enterprises;
- appreciate the features and merits of these enterprises;
- analyse the changing role of public sector;
- critically examine the role of multinationals in India.

6.1 Introduction

In the previous chapter, we have discussed the features, merits and limitations of organisations formed in the private sector. However, state ownership and operation of industrial and commercial undertakings were common features of the economic enterprises in most of the countries in the recent past. The concept of welfare state, the ideology of socialism, and the adoption of economic planning were the main factors behind the expansion of public enterprises in developing countries in latter part of the twentieth century. In this chapter, we shall discuss the organisational forms and role of public sector enterprises in the country. In addition to that, we will also discuss the meaning and features of global enterprises (multinational companies).

6.2 Private Sector and Public Sector

In India, since the advent of economic planning, state undertakings have been increasing in number. Government nationalised quite a few enterprises and also established new undertakings in various sectors of the national economy. The Industrial Policy Resolutions of 1948 and 1956 assigned dominant role to the state in the spheres of industrial, commercial and public utility activities. However, the role of private sector in economic development of the nation continued to grow in the defined sectors of the economy.

Before 1991, the private sector was always restrained from entering certain areas of business by a number of entry barriers. These entry barriers were in the form of licensing, limits on expansion and reserving too many areas for the public sector and small scale industries. Besides this, many complicated laws and procedures proved to be a major impediment to the growth of the private sector.

As discussed in the previous chapter, business enterprises can be of different forms viz. sole proprietorship concern, partnership, joint Hindu family business, cooperative societies and joint stock companies. Companies are of two types: private company; and public company. This constitutes the private sector in India's economy which is also shaped by the economic policies of the government. Thus, the government of India from time to time envisages the role of the private and public sector in its five year plans. The public sector enterprises constitute those which are fully or partly owned or controlled by the central and state government.

India had adopted the planned structure of economic growth where the public and private sector were to play assigned roles. Five year plans were drawn up with resources allocated to different sectors by central planning authorities. It was a licensed closed economy. The public sector was given a major role to play to take the nation to commanding heights. In the initial years the private sector was in the growth stage and was not willing to

enter areas which had long gestation periods and required huge investment in funds.

The Industrial Policy, 1991, laid greater emphasis on the role of the private sector industries. Major policy initiatives and procedural reforms were introduced to actively encourage and assist the entrepreneurs in the private sector. Industrial licensing was abolished except in areas related to security and strategic concerns. The areas reserved for the public sector were reduced and private sector participation in these areas increased. The Monopolies and Restrictive Trade Practices Act has been amended to eliminate the legal requirement for prior government approval for expansion and provisions related to merger and takeover also revised.

In the last decade or so, with the private sector marching ahead and taking a lead in industry, the business environment has undergone a tremendous change. These changes have ushered in a healthy industrial climate with openness and competition between the public and private sectors of the economy.

6.2.1 Rationale of Public Sector

Immediately after independence, India had to go in for rapid economic and social development to overcome the problems of poverty, unemployment, illiteracy, health and imbalance in regional economic growth. The country also needed major initiative in the area of defence requirements, basic and heavy industry and infrastructure to sustain development over a period of time. The rationale of initiating public sector enterprises to rebuild the nation economically and socially are given below:

(i) Defence requirements: Investment in the public sector was essential to ensure a continuous supply of goods and services needed for defence forces of the country. Strategic supplies cannot be left to the whims of the private sector.

(ii) Basic and heavy industries: The state has the responsibility to start basic and heavy industries requiring huge capital outlay and having longer gestation period. The private sector may not venture to establish such industries because they do not yield quick profits.

(iii) Public utilities: Since the private sector is motivated with earning profits, the public utility services like water supply, electricity, gas, public transportation where ready profit opportunities do not exist, may not be touched by the private sector. The state has to assume the responsibility of providing such services in the interest of public convenience and welfare.

(iv) Preventing concentration of economic power and monopolies: Takeover of private industrial enterprises by the state is also prompted by the policy of preventing monopolies and concentration of economic power which lead to inequalities in the distribution of income and wealth and exploration of resources to the detriment of society.

(v) Infrastructure: Infrastructure comprising transport, communications, irrigation, conservation of resources, power, etc., can be developed on large scale only by the state. Such projects demand long gestation period and relatively lesser return on investment.

(vi) Curbing wasteful expenditure: If any industry is not able to achieve optimum result because of wasteful competition, the state may nationalise it and make it a viable entity. It would be possible to realise economies of large scale operations. For example, all Air transport companies were nationalised in 1953 and two Statutory Corporations were formed — Indian Airlines Corporation and Air India International Corporation — because none of the companies under private ownership could be managed efficiently.

(vii) Development of backward regions: Government is justified in locating new enterprises in the backward areas rather than allowing the private sector to multiply its units in the already advanced areas. The balanced development of all regions is one of the worthy aims of state ownership of industry and trade.

(viii) Financing economic development and full employment: The ideas of economic growth and employment can be fulfilled only by massive investment by the state. The state can mobilise resources to finance developmental efforts and employment programmes out of the surpluses generated in the working of its enterprises.

(ix) Socialist pattern of society: The philosophy of socialism implies that the state will have full control over the *commanding heights* of the economy with private sector playing only complementary role. Hence, India adopted socialism to follow a policy of enlarging public sector in all crucial spheres to tighten its hold over the economy and accomplish the objectives of faster growth with social justice.

6.3 Forms of Organising Public Sector Enterprises

Industry and trade, either publicly or privately owned, has to be managed on sound business principles. The activities of public enterprises are organised in a different form than the private sector enterprises since they are oriented differently in terms of ownership, responsibilities and objectives. The justifications for suitable forms of organising public sector activities are explained below:

(i) Private sector enterprises assume gigantic proportions through a process of evolution, while giant public enterprises come into existence within a very short span of time just by a government decision. The interplay of economic forces is either cut short or sometimes superseded by government political decisions. The Tata Iron and Steel Works was

set up in 1911 and had gradually, expanded and reached to a capital investment of about Rs 100 crore in 1960 while the idea of setting up steel plant in the public sector was conceived during the First Five Year Plan and after nearly ten years in 1960, Hindustan Steel had four times more capital investment than Tatas.

(ii) The newness of public enterprises with no previous experience and history specially, in a developing country like India creates problems of recruitment, training of managerial personnel and so on. As a result of the inadequacy of managerial talents at the disposal of the state, public enterprise management is generally, manned by civil servants.

(iii) The private sector is not as much subject to public criticism as the public sector. Economic barometers judge the private sector, while in judging the performances of the latter, non-economic factors are equally important.

(iv) In private enterprise, business autonomy is ensured by top management which represents the shareholders and to whom an enterprise owes business accountability. In public enterprise, matters become more complicated for the simple reason that a synthesis of *political accountability* and *business autonomy* has to be found.

(v) In private enterprise from the foreman upwards there are distinct levels of management. Up to the Board of Directors, the levels are identical in the two sectors, but beyond this public enterprises have many more layers than in private enterprises. Over the board, there is the parent ministry and other related ministries, the planning authority, and lastly, the Parliament which represents shareholders.

(vi) Public enterprises, being created by the state, have to lean heavily on the state administrative machinery for the solution of their numerous policies as well as day-to-day administrative problems. A private enterprise can set up its own facilities like power plant if it finds it more economically viable without involving any other authority.

(vii) A public enterprise, being financed out of state funds, has larger financial resources, while a private enterprise has to compete with its rival enterprises for getting funds out of the common pool of *investment capital*.

(viii) The management of public enterprises must be *public interest* oriented. A private enterprise management cannot, in the present-day world, completely ignore public interest because of the regulatory laws or its duty towards the social order. It serves the public interest as it sees it, while in a public enterprise management has to serve the

public interest as seen by the state.

(ix) In a private enterprise, there is hardly any contradiction in the goals, which an enterprise is suppose to attain but in public enterprises there is often a conflict between profitability and public interest to be pursued as goals.

Keeping in view, the different orientations and requirements, public enterprises are organised in three different forms: (a) departmental undertakings; (b) public corporations; and (c) government companies. Meaning, features and critical evaluation of each form of organisation are explained below:

6.3.1 Departmental Undertakings

This form is the oldest form of organising and managing the affairs of state enterprises. Under this type of organisation, business activities of the undertaking are conducted under the over all control of one of the departments of the government. The department is under a high level official, who is given necessary executive powers. In India, Railways, Posts and Telegraphs, Telephone Services, Broadcasting, Defence Undertakings like Ordinance Factories, etc., are administered through the departments of the government.

Features

(i) It is administered by one of the several departments of the government attached to a particular ministry.

(ii) It is subject to direct ministerial control.

(iii) The activities of the enterprise are under the control of the top officer acting as the executive head of the department.

(iv) It is financed out of annual allocations from the general budget of the government. Most of the earnings are paid into the government treasury. It is the treasury which releases funds to the department for onward release to the enterprise for its expenditure required for various purposes.

(v) It is subject to government budget, accounting and audit controls.

(vi) The members on the staff of the departmental undertakings are usually, civil servants, who are subject to the normal method of recruitment and conditions of service meant for civil servants.

Merits

(i) Since control is direct and centralised, it is likely to be effective.

(ii) Since the officers are under the direct administrative control of the ministry, they are guided by rules and regulations framed by the ministry.

(iii) As the financial operations of the department are subject to ministerial sanction, budget, accounting and audit control, the

risk of misuse of public money is relatively less.

(iv) The revenue of the government is likely to increase since the earnings of the department are credited to the treasury. The tax burden on the community thereby becomes lighter.

Limitations

(i) Due to excessive centralisation of control, flexibility, initiative and prompt action so essential for the successful operation of a business undertaking, are lacking.

(ii) Since it has no powers to utilise its revenues, there is practically no incentive as such to maximise its earnings.

(iii) Due to the absence of competition and profit motive, losses incurred by the department are not taken seriously. Hence, it may prove inefficient and unresponsive to consumers' needs and tastes.

(iv) Losses incurred by departmental enterprises are made good out of the treasury. This amounts to underwriting of losses, which may necessitate additional taxation.

(v) Lack of courtesy on the part of officers and personnel creates ill will among the consumers, which is harmful to any business enterprise.

(vi) Red tapism and bureaucracy are the glaring drawbacks of departmental organisations. Rigid compliance with the administrative formalities makes the undertaking inflexible and unresponsive to changes in technology, fashions, needs and tastes of the day. The delay in decision-making due to excessive paper work makes the enterprise a victim of official red tapism. Innovations, risk taking, bold approach, initiative, prompt adjustability so essential for the growth of an enterprise has no place in a departmentally run enterprise.

6.3.2 Public Corporations

A public corporation, also known as statutory corporation, has been defined as an administrative unit constituted on autonomous basis by an Act of Parliament. Public corporation is a body corporate created by an Act of Parliament or State Legislature and notified in the Official Gazette of the Central or the State government. It is a corporate entity having perpetual succession and common seal with powers subject to provisions of the governing Act to acquire, hold, dispose of property and sue and be sued by its name. The Life Insurance Corporation of India, Indian Airlines, Air India, Oil and Natural Gas Commission, Food Corporation of India, and Central Warehousing Corporation of India are some examples of Indian public corporations.

Features

(i) It is created by an Act of Parliament or a State Assembly. The powers and duties of a public

corporation and its relations with the government (Ministry) and Parliament are defined in the Act passed in that behalf.

(ii) It is a separate legal entity entitled to enter into contracts independently to borrow money on its own initiative, to acquire property in its own name, etc.

(iii) It is wholly owned by the state. In other words, the central or state government mostly provides the capital. A part of the capital may be issued to non-governmental agencies or a part of it may be raised in the form of public loans.

(iv) Members of the board of directors are nominated by the government. The board may consist of part time or full time members. They may be officials or non-officials, or both.

(v) It is relatively free from political, parliamentary and departmental interference in the exercise of the powers delegated to it under the Act. Thus, it enjoys administrative autonomy.

(vi) It has an independent financial structure. It prepares its own budget and has authority to retain its earnings and utilise them for its business. Thus, it enjoys financial autonomy also.

(vii) Employees of the public corporation may not be part of the general *administrative service* of the government. It has its own rules of recruitment and remuneration for its staff and employees.

(viii) Profit motive is not the main consideration. But, legitimate profits, if earned, are welcome as a test of its efficiency.

(ix) Public accountability is also an important feature. No doubt it enjoys administrative and financial autonomy, but it is accountable to Parliament or State Legislature for its operations. It has to submit its annual report on its working. Its accounts are usually audited by the Comptroller and Auditor General. The reports as well as the audited accounts are presented to Parliament or Legislature, which is entitled to discuss them.

Merits

(i) In view of its autonomous set up a public corporation is able to manage its affairs with independence, initiative and flexibility.

(ii) It is relatively free from red tapism and bureaucracy. A public corporation can take quick decisions and prompt action on any matter relating to its business

(iii) Their policies are subject to ministerial directives and broad parliamentary control. This ensures protection of public interest.

(iv) It can provide better amenities and more attractive terms of service to its staff and secure greater working efficiency. Therefore, labour trouble too is less frequent.

(v) Its price policy is framed strictly in accordance with commercial principles of cost benefit relationship. Thus, avoiding excessive margin of profit better safeguards the interests of consumers.

(vi) Its governing board (or board of directors) consists of business experts and also the representatives of various interests like labour, consumers, nominated by the government. Thus, there is less likelihood of exploitation of any class at the cost of another.

Limitations

(i) Autonomy and flexibility, which are the basic characteristics of public corporations, have remained in name only. In practice, the ministers, government officers and political interests very often interfere with working of these corporations. For example, Damodar Valley Corporation (DVC), has reached its low due to government apathy. Generation is low, ongoing projects are held up for paucity of funds, there is no money to buy coal for the power plants and hundreds of crores of rupees are due from different government agencies.

(ii) The governing boards of public corporations may themselves abuse their autonomous authority and indulge in undesirable practices that would defeat the social objectives of public ownership

(iii) Since public corporations have not to face any competition and are not guided by profit motive, not haunted by the fear of losses, commercial principles are likely to be ignored in their operations leading to inefficiency and losses. The losses are then made good by the government through subsidies.

6.3.2 Government Company

Joint stock company form of organisation and management has been adopted for public enterprises engaged in manufacturing and marketing activities. Sindri Fertilisers and Indian Telephones were the first to be transferred from private sector to government ownership. Thereafter, many industries and industrial enterprises nationalised or newly established by the government have been organised almost invariably as joint stock companies owned and operated by the government. Examples are: Steel Authority of India; Hindustan Aircrafts; Hindustan Machine Tools; State Trading Corporation; Mysore Sugar Company; etc.

Government company means any company in which not less than 51 per cent of the paid-up share capital is held by the central government or state governments or partly by central government and partly by one or more state governments. It includes a

company, which is a subsidiary of a government company as thus, defined. A government company, therefore, is an enterprise wherein the government is a predominant shareholder having controlling interest.

The government companies are governed under the rules and regulations laid down in the Companies Act like any other registered company. However, the government has the authority under the Companies Act to direct through notification in the Official Gazette that any of the provisions of the Companies Act shall not apply to any government company or shall apply to the government company with certain exceptions, modifications and adaptations.

Features

(i) A government company is registered under the Companies Act, 1956 like any other joint stock company in the private sector. It is subject to the provisions of the company law regarding registration, memorandum, articles, meetings, capital structure, accounts, audit, etc. The only exceptions are those regulations, which may be excluded by the government by special notifications duly approved by the Parliament.

(ii) The bulk of the share capital is held by the government, central or state, or partly by the central and partly by the state governments. Usually, the share capital of these companies in India is owned by the government of India in the name of the President. But, sometimes shares are allotted to a collaborator for technical know how. Qualification shares may also be held in the names of office bearers in order to comply with the legal requirements concerning the minimum number of directors, etc.

(iii) The board of directors is in effect a nominated body of the government. Being in possession of majority shares of the company, the government has the authority to appoint majority of the directors.

(iv) The elaborate and complicated rules and dilatory procedures common with a departmental organisation of the government do not bind these companies. They can function independently with full discretion in the normal administration of the affairs of the undertaking. Administrative autonomy and financial freedom are ensured for government companies though they do not have a special legal status of public corporations created under special law.

(v) A government company is subject to ministerial control. The concerned ministry makes appointments of directors. The ministry may issue directions that is binding on the company and it is entitled to call for any information from the company. It

can assume the overall supervision of the undertaking.

Merits

(i) The government company is comparatively free from the time consuming regulation and can function freely and smoothly under the general vigilance of the government. It retains its independence in respect of finance, appointment of personnel, general administration, etc.

(ii) Suitable changes can be introduced, whenever needed, within the general provisions of the company law, without amending the legislation. In case, any provision of the Companies Act appear to be obstructive to the organisation independence and accomplishment of public interests, the government has the power to exempt the company from the purview of the operations of the concerned regulations of the Companies Act.

(iii) There is no undue departmental interference in the working of the government company. It is managed, financed, taxed and audited just as is the case with other companies in the private sector. It can, therefore, secure *commercial basis, greater flexibility, freedom of operations and quickness of action* in running the state enterprises

(iv) Government company is regarded as the choicest compromise between the rigid departmental pattern and completely autonomous public corporation form of organisation

(v) It enables the government to acquire and accommodate managerial skill, technical know how or expertise of the private enterprise by conveniently collaborating with it.

Thus, the best of public interest and private initiative is blended with greater ease and effectiveness by adopting the government company form of organisation for state enterprises

Limitations

However, the above mentioned points of merit need not make us complacent. There are certain inherent limitations of this form of organisation. These are given as under:

(i) The relatively independent character of the government company has failed to find expression in practice. Government being the sole or the bulk shareholder dictates its terms and the management is conducted by board of directors according to the will of the government.

(ii) The control exercised by the government, over these companies is so vast or all pervading that they are reduced to mere adjuncts to the ministries and subjected to the same treatment as given to the subordinate organisation or offices of the government.

(iii) Ministerial interference in the working of the government company is found to be frequent and far reaching. The government department influence or twist the operational policies of the companies according to the whims and fancies of the ministers, and secretarial officers' exercise undefined and unrestricted authority.

(iv) The autonomy of the government companies is vitiated by the executive orders of the government issued without reference to the Parliament. Also there is interference in the day-to-day activities of the organisation.

(v) Officials from the ministerial departments dominate the board of management of the government companies in their ex-officio capacity. These officials do not develop any sense of attachment and do not show any initiative and drive (as they have no direct financial stake in the working of the concern) essential for increasing productive activity and efficiency.

(vi) The departmental officers appointed to top posts in the

Government Interference in Public Enterprises

Investment choice: Massive capacity for casting, forging and machine building was created at Heavy Engineering Corporation, Ranchi which cannot be utilised. The Surgical Instrument Plant set up at Madras was handicapped from the start by the virtual absence of demand for its product, which was based on Russian design

Choice of technology: BHEL – Siemens collaboration agreement has brought to light the fact that this was forced on the company as a result of ministerial decision, although the chairman of BHEL was opposed to it

Location choice: Choice of location has to be with reference to techno-economic considerations. The Hindustan Paper Corporation Project was located at Tuli, which is on hilltop, in preference to Dimapur despite objections by the managing director of the company

Pricing policy: Sometimes prices are kept below the cost of production or cost of operations, as in the case of Electricity Boards and Transport Corporations, due to deliberate government policy born out of political considerations, with the result public enterprises have to suffer losses.

Personal motivation: Certain ministerial interventions hint at personal rather than social reasons, as in the LIC-Mundra case where, due to the informal advice by the minister, shares were purchased by the LIC resulting in huge losses.

executive control of these companies are not likely to show unflinching loyalty to the progressive growth of the concerns under their charge. They are liable to be transferred back to their original departments. Hence their divided loyalty reduces their interest in carrying out the responsible tasks assigned to them as managers of the government companies.

(vii) It evades the constitutional responsibility to the government and the Parliament and works neither for the government nor for the public at large but serves the personal interests of the people, who are working in the organisation and those who dictate the policies of the organisation.

A brief summary of comparative view of various forms of public enterprises have been presented on the next page.

6.4 Changing Role of Public Sector in India

The public sector has been playing a vital role in the economic development of the country. In fact, the public sector has come to occupy such an important place in our economy, that on its effective performance depends largely the achievement of the country's economic and social goals. Public sector is considered to be a powerful engine of economic development and an important instrument of self reliance and social justice. The main contributions of public enterprises to the country's economy are: filling gaps in the industrial sector; employment generation; balanced regional development; contribution to public exchequer in the form of dividend, corporate taxes; excise and custom duties; improving balance of payment position; development of ancillary industries; research and development; and community development.

Despite their impressive role, public enterprises in India suffer from several problems and shortcomings. Some of these are: poor project planning; over capitalisation; excessive overheads; over staffing; under utilisation of capacity; lack of proper price policy; inefficient management; unsatisfactory industrial relations and lack of coordination among functional activities. Public enterprises have shown a very low return on the capital employed. This has inhibited their ability to regenerate themselves in terms of new investments as well as in technology development. The result is that many of the public enterprises have become a burden rather than being an asset to the government. The original concept of public sector has also undergone considerable dilution. The most striking example is the take over of sick units from the private sector. This category of public sector units accounts for almost one third of the total losses of central public enterprises. Another category of public enterprises, which does not fit into the original idea of public sector being at the commanding heights of the

Comparative Features of the Various Forms of Public Enterprises

Basis of Comparison	*Departmental Organisation*	*Government Company*	*Public Corporation*
Formation	By a ministry without private participation	By registration under the Companies Act, with or without private participation	By a special Act of Parliament or State Legislature without private participation
Legal status	No separate entity,	Single legal entity	Separate legal entity
Capital, financing, and borrowing powers	Through budgetary appropriations, can't borrow	Separate financing, can borrow, private participation possible	Provided wholly by the government, but can borrow
Management control	Government officials from the Ministry concerned	Board of directors may include private individuals	Nominated board of directors, Parliamentary control
Staffing system	Government servants civil service code	Not government servants – contract of service	Not government servants – contract of service
Autonomy	No autonomy – a wing of the government	Some freedom from government interference	Sufficient autonomy, government does not Interfere in the day-to-day affairs
Ownership	Wholly owned by the government	At least 50 per cent shares owned by the government	Wholly owned by the government
Public Accountability	Highest, direct control by Minister	High, Ministry concerned	Higher, Parliament and Ministry concerned
Flexibility of operations	Little- rule bound	Moderate	Considerable
Suitability	Defence and public utility undertakings requiring utmost secrecy and strategic significance	Industrial and commercial enterprises requiring participation of domestic and foreign private capital	Industrial and commercial enterprises of national importance

economy, is the plethora of public enterprises which are in the consumer goods and service sectors.

In the light of above experiences, the government adopted a new approach to public enterprises. Some of the major initiatives are given below:

(i) Restricting the role of public sector: Units, which may be faltering at present but are potentially viable, must be restructured and given a new lease of life. The priority areas for growth of public enterprises in the future will be the following:

(a) Essential infrastructure goods, and services.

(b) Exploration and exploitation of oil and mineral resources.

(c) Technology development and building of manufacturing capabilities in areas which are crucial in the long-term development of the economy and where private sector investment in inadequate.

(d) Manufacture of products where strategic considerations predominate such as defence equipment.

(ii) Strengthening enterprises through 'Memorandum of Understanding': Government will strengthen those public enterprises, which fall in the reserved areas of operation or are in high priority areas or are generating reasonable profits. Such enterprises will be provided much greater degree of management autonomy through the system of Memorandum of Understanding. Competition will also be introduced in these areas by inviting private sector participation. In the case, of selected enterprises, part of government holdings in the equity share capital will be disinvested in order to provide further market discipline to the performance of public enterprises. There is a large number of chronically sick public enterprises incurring heavy losses, operating in a competitive market and serve little or no public purpose. These need to be attended to.

(iii) Product restructuring: Product portfolio of public sector enterprises will be reviewed with a view to focus the public sectors on strategic, high technique and essential infrastructure. Whereas, some reservation for the public sectors is being retained, there would be no bar for areas exclusively to be opened up to the private sector selectively. Similarly, the private sector will also be allowed entry in areas not reserved for it.

(iv) Privatisation of public enterprises: There is a strong move to privatise most of the public sector undertakings specially, whose chances of revival is remote and have little strategic value for the government. Government is also learning from the world experiences of privatisation and is coming out decisively from business. Though, the speed of privatisation is slow and clumsy but it will pick up soon by making the procedural mechanism transparent and stating the disinvestment objectives clearly in each case.

(v) Revival and rehabilitation through BIFR: Public enterprises which are chronically sick and which are unlikely to be turned around will,

for the formation of revival/rehabilitation schemes, be referred to the Board for Industrial and Financial Reconstruction (BIFR), or other similar high level institutions created for the purpose. A social security mechanism will be created to protect the interest of workers likely to be affected by such rehabilitation packages.

(vi) Professional management: Board of directors of the public sector companies should be made more responsive to the interests of various stakeholders while framing policies for the concerned enterprise. Management personnel should also be allowed operational freedom in implementing policies framed by the board.

(vii) Provision of National Renewal Fund: To protect the interest of public sector workers, a National Renewal Fund (NRF) was set up in February 1992 to assist the employees in retraining, redeployment and counselling. Provision of funds through NRF also exists for cases where workers retire voluntarily or are declared surplus.

(viii) Financial restructuring: In order to raise resources and encourage wider public participation, a part of government's shareholding in the public sector would be offered to mutual funds, financial institutions, general public and workers. Government of India has taken a number of steps in this direction. Though the speed of disinvestment is not satisfactory but in time to come it will pick up in the light of Supreme Court judgement favouring disinvestment of public sector companies.

6.5 Global Enterprises (Multinational Companies)

Global enterprise is one that integrates its operations that are located in different countries. It might design a product or service with a global market segment in mind. Or it might depend on its operations in different countries to produce the components used in its products and services. Organisations

Disinvestments in Public Sector Undertakings

Year	*Target (Rs in Crore)*	*Achievement (Rs in Crore)*
1991-92	2500	3038
1992-93	2500	1913
1993-94	3500	Nil
1994-95	4000	4843
1995-96	7000	362
1996-97	5000	380
1997-98	4800	902
1998-99	5000	5372
1999-00	10000	1829

like Nestle and Sara Lee earn most of their profits outside their home countries, but because they acquire and develop existing brands, the fact of their ownership usually is not known widely. They make the world rather

Disinvestment Chronology

1991	Disinvestment kicked off with the decision to offload 20 per cent government stake in 31 PSUs.
1992	Government disinvests 7.5 per cent stake in Rashtriya Chemicals & Fertilisers.
1993	Government offers 51 per cent stake in Indian Iron & Steel Co. for sale.
1996	Disinvestment Commission set up under G.V. Ramakrishna. It submits 12 reports on 53 PSUs before it is dissolved in November 1999.
1997	Gas Authority's GDR issue withdrawn after it was realised that the scrip would fetch only Rs 115 crore as against the expected of Rs 150-170 crore.
1998	Cabinet okays disinvestment of 50 per cent stake in Hindustan Teleprinters. This is raised to 74 per cent in May 2000. Green signal also given to privatisation of Modern Foods, and Ranchi Ashok and Utkal Ashok Hotels.
1999	Government earns Rs 5371 crore against the Rs 5000 crore disinvestment target for 1998-99. Of this, Rs 4867 crore comes through equity swaps among the oil companies. GAIL picks up 2.5 per cent stake in ONGC; ONGC and IOC take 5 per cent each in GAIL; and IOC and ONGC buys 10 per cent in each other government identifies sectors for disinvestment. Decides not to disinvestment in strategic sectors: defence-related production, railway transportation, and atomic energy. Disinvestment in all non-strategic sectors can go up to 100 per cent The first strategic sale is concluded with Calcutta-based Murlidhar Ratan Lal Export buying 74 per cent government stake in Lagan Jute Machinery.
2000	A Ministry for disinvestment has been set up. Modern Food sold to Hindustan Lever for Rs 105 crore. Government decides to offload 51 per cent stake in Indian Airlines, with 26 per cent going to strategic investor. Government decides to disinvest 60 per cent of its holding in Air India.
2001	The Union Government has decided to sell 51 per cent equity in Indian Petrochemicals Corporation Ltd. Fifty one per cent stake in Balco was sold to Sterlite Industries for Rs 551.5 crore. Fifty one per cent stake in CMC sold to Tata Sons for Rs 152 crore. Seventy four per cent stake in Hindustan Teleprinters sold to Himachal Futuristic Communication for Rs 74 crore. Two Hotel Corporation of India hotels sold for Rs 159.51 crore – Juhu Centaur for Rs 153 crore to the Ajit Kerkar-promoted Tulip Company, and Centaur Rajgir at Rajgir to Inpac Travels India for Rs 6.51 crore. Six of eight ITDC hotels were sold for Rs 60.23 crore.

PSU Sell Offs

Disinvestment is one area where the government has made substantial progress. The government has graduated from off loading small, loss-making bakeries to selling off large, profitable telecom and oil companies. It has demonstrated that it has the political will to stand up to criticism and to go ahead with the privatisation programme even in adverse circumstances, such as their being a sold bidder and bid being below the reserve price.

The government has successfully sold its majority equity in VSNL, CMC, IBP, NTL and PPL without any significant opposition from political parties or the labour unions. The only setback to the disinvestment process was that the government was not able to sell Air India. The government is likely to get around Rs 6000 crore from disinvestment. They have already received Rs 3200 crore from the sales of CMC, NTL, VSNL, IBP and ITDC. Another Rs 157 crore will come in from the sale of Paradip Phosphates.

Source : The Economic Times

than a single country *home*. For example, oil and natural gas giant Unocal remains headquarters in California, but no longer considers itself a US company; describes itself as a global energy company; and in April 1997 opened a *twin* headquarters in Malaysia to serve as the base for several senior executives. Thus, a global company is (a) less place-bound and less tied to the traditions of a single nation; and (b) known for its products but whose national links are less clear.

The term *multinational* consists of two different words, *multi* and *national*. The prefix *multi* here means many while the word *national* refers to nations or countries. Therefore, a multinational company may be defined as a company that operates in several countries. Such a company has factories, branches or offices in more than one country. According to the United Nations Commission on Multinational Corporations, a Multinational Corporation is a Corporation, which operates, in addition to the country in which it is incorporated in one or more other countries.

A multinational corporation is also known as a *transnational corporation*, *global enterprise*, *world enterprise* or *international enterprise*. The operations of a multinational corporation (MNC) extend beyond the country in which it is incorporated. Its headquarters are located in one country (home country) and in addition it carries on business in other countries (host countries). For example, Coca-Cola Corporation has its headquarters in the USA and it has branches/subsidiaries in several countries. A multinational corporation controls production and marketing

Global Industries and Participants

Advertising	:	Saatchi & Saatchi, Havas, Omnicom, WPP Group, Dentsu
Automotive tyres	:	Bridgestone, Groupe Michelin, Goodyear, Sumimoto Rubber, Continental
Athletic shoes	:	Nike, Reebok, Adidas, Fila, Puma, K-Swiss, Diadora
Beer	:	Heineken, Guinness, Anheuser, Busch, Fosters, Kirin, Millers
Confections	:	Cadbury Schweppes, Mars, Hershey, Nestle, Haribo
Container shipping	:	Evergreen Marine, Hyundi, Cosco, GP Livanos, Sea-land Service
Cosmetics	:	L'Oreal, Estee Lauder, Avon, Shiseido, Bodyshop, MAC, hard Candy
Motor cycles	:	Suzuki, Harley Davidson, Piaggio, Honda, Aprilia Moto
Petroleum refining	:	Royal Dutch/Shell, PEMEX, British Petroleum, Imperial Oil, Texaco
Photographic equipment	:	3-M, Kodak, Fuji, Casio, Epson,
Publishing	:	Thompson, Dow Jones, Reed Eslevier, Bertelsman, Quebecor
Retailing	:	IKEA, Carrefour, Marks & Spencer, Makro, Hudson's Bay, Wal-Mart
Video games	:	Nintendo, Sega, Sony, Philips, Mattel

facilities in more than one country. Firms that participate in international business, however, large they may be, solely by exporting or by licensing technology are not multinational corporations.

Features

(i) Giant size: The assets and sales of multinational corporations are quite large. The sales turnover of some MNCs exceeds the Gross National Product of several developing countries. For example, the physical assets of International Business Machines (IBM) exceed 8 billion dollars.

(ii) Centralised control: A multinational corporation has its headquarter in the home country. It exercises control over all branches and subsidiaries which operate within the policy framework of the parent corporation.

(iii) International operations: A

multinational corporation has production, marketing and other facilities in several countries. It operates through a network of subsidiaries, branches and affiliates in host countries. It owns and controls assets in foreign countries. Firms like PepsiCo, CNN (the global news network), and Benetton can be readily identified as multinational enterprises because they have fully established a global presence in virtually all their businesses.

(iv) Oligopolistic power: Multinational corporations are generally, oligopolistic (few firms in the same line of business) in nature. Due to their giant size they occupy a dominant position in the market. They also take over other firms to acquire huge economic power. For example, Hindustan Lever Limited acquired Tata Oil Mills, Ponds India etc., and thus, has improved its market share in personal wash, washing powder, washing bars, shampoos and skin care creams.

(v) Sophisticated technology: Generally, a multinational corporation has at its command advanced technology so as to provide world class products and services. It employs capital intensive technology not only in manufacturing but in marketing and other areas of business too.

(vi) Professional management: In order to integrate and manage worldwide operations, a multinational corporation employs professional skills, specialised knowledge and training. It employs professionally trained managers to handle advanced technology, huge funds and international business operations.

(vii) International markets: On account of its vast resources and superior marketing skills, a multinational corporation has vast access to international markets. Therefore, it is able to sell whatever products /services it produces in different countries.

Role of Multinationals

Multinational corporations play both positive and negative roles. As a positive force, multinationals can be dynamic force or instrument for wider distribution of capital, technology and

The Benetton Model

Originally, a small family-owned knitwear company, Benetton has expanded since the 1980s into a significant multinational business enterprise with 5000 franchise stores in all the world's major markets. Controlled directly from its central HQ in the Veneto region of Italy, the company utilises advanced communications systems to monitor and manage its global distribution network. Similarly, products are manufactured by small independent firms in Europe and elsewhere, organised as transnational production network directed from Benetton's HQ. The company represents a curious combination of hierarchical control through horizontal networks of distribution and production.

Foreign Direct Investment (in US $ Billion)

Year	*India*	*China*
1992	0.23	11.16
1993	0.55	27.52
1994	0.97	33.79
1995	2.14	35.85
1996	2.43	40.18
1997	3.58	44.24
1998	2.64	43.75
1999	2.15	40.32
2000	2.32	40.77

employment. As a negative force, multinationals can act as monsters beyond the control of national governments and working against public interests.

Multinationals can offer the following gains to host countries

(i) Employment generation: Multinationals create large scale employment opportunities in host countries. They increase the investment level and thereby the employment and income levels. Multinationals offer excellent pay scales and career opportunities to managers, technical and clerical staff.

(ii) Foreign capital: Developing countries suffer from shortage of capital required for rapid industrialisation. Multinational corporations bring in much needed capital for the development of these countries. These corporations make direct foreign investment thereby speeding up the process of economic development. Since liberalisation, China has, for example, attracted investment worth several billion dollars.

(iii) Advanced technology: Developing countries are technologically backward. They lack sufficient resources to carry on research and development. Multinationals serve as vehicles for the transfer of advanced

India's Silicon Valley

The $485 million software work produced annually in India represents only a tiny portion of the $85-150 billion estimated annual worth of the software industry, but it represents 125000 jobs for software engineers, many of whom are located in Banglore near the Southern tip of India. Educational attainment in India is highly valued, but until recently, few Indian software engineers could apply their skills globally. Advent of the Internet has transferred current software expertise throughout the world. including Bangalore, and a shortage of software engineers in the USA sends firms there on a search for talented workers. According to one estimate, as many as 75 fortune 500 companies have started contracting with India for software development, including Nordstrom and Microsoft.

technology to these countries. Advanced technological know how, imported skills, and consultancy help the developing countries to improve the quality of products and reduce costs. Through continued research and development, MNCs serve as a source of inventions and innovations (See Silicon Valley).

(iv) Growth of domestic firms: MNCs stimulate the growth of local enterprises. In order to support its other operations, a multinational may assist domestic suppliers and ancillary units.

(v) Improve inflow of foreign currency: Multinationals help the host countries to increase their exports and reduce their dependence on imports. As a result, these corporations enable the host economies to improve balance of payment position.

(vi) Standard of living: By providing superior products and services, MNCs help to improve living standards in host countries.

(vii) Managerial revolution: Multinationals help to professionalise management in the host countries. They employ modern management techniques and trained managers. Several concepts and techniques like corporate planning, management by objectives and job enrichment were evolved by multinational corporations. As carriers of knowledge and experience, multinationals build up *knowledge base* and thereby assist the development of human resources in host countries.

(viii) World economy: MNCs help to integrate national economies into a world economy. They encourage international brotherhood and cultural exchanges through international business.

(ix) Healthy competition: Multinationals increase competition and thereby break domestic protected monopolies. They compel the domestic companies to improve their efficiency or withdraw from the market. For example, many Indian companies (Mafatlal Industries, Crompton Greaves, Hero Cycles, Bharat Earth Movers, Escort Tractors, Hindustan Aeronautics, and so on) have acquired ISO 9000, 9001, 9002 quality certification due to competition from multinational corporations after liberalisation.

Criticisms of Multinationals

(i) Disregard of national priorities: MNCs invest in most profitable sectors e.g., consumer goods disregarding the goals and priorities of host countries. They do very little for underdeveloped strategic sectors and backward regions. Due to their capital intensive technology and profit mindedness, they create relatively few jobs and fail to solve the chronic problems e.g., unemployment and poverty of host nations.

(ii) Obsolete technology: MNCs often transfer outdated technology to their collaborators in host countries. In many cases, technology transferred was unsuitable causing waste of scarce capital. Repetitive imports of similar technology led to excessive royalty

What is ISO 9000 Series

ISO 9000 : It is a series of quality standards developed by a Committee of the International Organisation for Standardisation (ISO). The series contains certificates in many areas and a company can go in for one or more certificates depending on its operations or activities.

ISO 9000 : It is a quality standard that sets out the methods by which a management system incorporating all the activities associated with quality, can be implemented in an organisation to ensure that all the special performance requirements and the needs of the customer are fully met. The system applies to the quality management systems a company uses, not its products.

ISO 9001 : It provides the model for an organisation, which is involved in the management or design as well as in the producing the product or service. Thus, in service organisations or organisations providing professional services where the service offered is designed to meet the specific needs of the customer.

ISO 9002 : It is an appropriate model for many manufacturing industries producing standard items or service organisations, such as retailing outlets providing a standard service.

ISO 9003 : It is only used for those organisations whose product is already manufactured and is simply inspected before being supplied.

ISO 9004 : It requires that a company's service be defined with specific characteristics documented, such as dependability, capacity, safety, security, courtesy and accuracy. The standard also addressed the importance of employee involvement and motivation in providing quality service and vesting a service quality loop, which enables internal and external measurement of customer service.

payments without adding to technical knowledge in host countries. Sometimes, machinery available locally was imported or it remained idle for want of repairs and maintenance facilities. MNCs have failed to develop local skills and talents.

(iii) Excessive remittance: MNCs squeeze out maximum payment from their subsidiaries/affiliates and collaborators in the form of royalty, technical fee, dividend etc. By repatriating profits, MNCs put severe pressures on the foreign exchange reserves and balance of payments of host countries.

(iv) Creation of monopoly: MNCs join hands with big business houses and give rise to monopoly and concentration of economic power in host countries. They kill indigenous enterprises through strategic advantages like patents, superior technology, etc. For example, Parle Soft Drinks and Kwality Ice Cream Company had to sell themselves to foreign MNCs in India.

(v) Restrictive clauses: Due to their strong bargaining power, MNCs introduce restrictive clauses in collaboration agreements e.g., technology cannot be passed on to

third parties, pricing of products will be by the MNCs, export from host country will be restricted and managerial posts will be filled by parent company. MNCs do not transfer research and development, training and other facilities to host countries.

(vi) Threat to national sovereignty: MNCs pose a danger to the independence of host countries. These corporations tend to interfere in the political affairs of host nations. Some MNCs like International Telephone Industries are accused of overthrowing governments in countries such as Chile.

(vii) Alien culture: MNCs tend to vitiate the cultural heritage of local people and propagate their own culture to sell their products. For instance., MNCs have encouraged the consumption of synthetic food, soft drinks, etc., in India.

(viii) Depletion of natural resources: MNCs cause rapid depletion of some of the non-renewable natural resources in host countries.

Thus, multinationals play both positive and negative roles. In recent years, India has adopted an open arm welcome policy towards MNCs. But experience reveals that the hopes with which MNCs were permitted in India have not been fulfilled. Most of the MNCs have entered in low-tech areas like soft drinks, toilet goods, electronics, etc. Several Indian companies were forced either to sell out or to serve as affiliates of MNCs. Therefore, it is necessary to safeguard the country's interests while allowing multinationals to operate in India.

Summary

State ownership and operational control of industrial and commercial undertakings were common features of the economic enterprises in most of the developing countries of the world. Their predominant role was rationalised on the following grounds: (a) defence requirements; (b) basic and heavy industries, (c) public utilities; (d) preventing concentration of economic power and monopolies; (e) infrastructure; (f) curbing wasteful expenditure; (g) development of backward regions; (h) employment generation; (i) contributing to exports and foreign exchange reserve. Public sector enterprises can be organised in three forms: departmental undertakings; public corporation; and government company.

Departmental undertaking form of organisation: They work under the overall control of one of the departments of the government. The features of this type of organisations are: (a) administered by one of the government departments; (b) subject to direct ministerial control; (c) Top officer of the government act as the executive head of the organisation; (d) financed out of annual budgets; (e) subject to government budget, accounting and audit controls; and (f) employees of the undertakings are treated as government servants.

Merits of the departmental undertakings are: (a) effective; (b) guided by rules and regulations framed by the ministry; (c) risk of misusing funds is relatively less; and (d) lighter tax burden.

Limitations of such undertakings are: (a) lacks flexibility, initiative and prompt action; (b) no incentive to maximise earnings; (c) inefficient and non-responsive; (d) increase tax burden; (e) lack of courtesy on the part of the officers due to bureaucratic orientation; and (f) red-tapism and bureaucracy.

Public corporations: They are administrative units constituted on autonomous basis by an Act of Parliament to undertake commercial or industrial activities in the economy. The main features of such corporations are: (a) created by an Act of Parliament; (b) separate legal entity; (c) wholly-owned by the government; (d) board of directors are appointed by the government; (e) free from political interference in the exercise of its powers; (f) independent financial structure; (g) not a part of general administrative service of the government; (i) profit motive is the secondary consideration; and (j) public accountability through Parliament.

Merits of such corporations are: (a) able to manage its affairs with independence, initiative and flexibility; (b) free from red-tapism and bureaucracy; (c) protection of public interest; (d) better service conditions; (e) price policy is based on commercial principles; and (f) board of directors consists of professionals.

However, public corporations are not free from limitations. Some of them are: (a) autonomy and flexibility are in name only; (b) misuse of autonomy; (c) losses are made good through government subsidies.

Government companies: These are companies whose more than 50 per cent share in paid capital is held by the central or state governments. The major features of such companies are: (a) incorporated under the Companies Act of India; (b) majority of shares are held by the government [s]; (c) majority of board of directors from the government; (d) administrative autonomy and financial freedom; (e) subject to ministerial control.

The merits of government companies are: (a) free from time consuming regulations; (b) freedom to amend general provisions of the Companies Act; (c) no undue departmental interference; (d) choicest compromise between the rigid departmental pattern and complete autonomous public corporation form of organisation, and (e) freedom to acquire and accommodate managerial skill and technical knowhow.

The government company form of organisation is also not free from limitations. Some of them are: (a) independent character is only in name; (b) acts more like adjuncts to government departments; (c) ministerial interference is pervasive; (d) vitiated autonomy; (e) lack of business acumen; (f) divided loyalty of government bosses; and (g) evades constitutional responsibility.

Changing role of public sector: Though the performance of public sector enterprises always has been a matter of debate, the role of this sector is changing very fast. Some of the initiatives in this regards are: (a) restricting the role of public

sector to critical areas; (b) strengthening enterprise through MOUs; (c) product restructuring; (d) privatisation; (e) revival and rehabilitation through BIFR; (f) professional management; (g) provision of national renewal fund; and (h) financial restructuring

Global enterprises: These companies integrate their operations that are located in different countries of the world. They are also known as international, multinational or transnational organisations. Main features of global enterprises are: (a) giant size; (b) centralised control; (c) international operations; (d) oligopolistic power; (e) sophisticated technology; (f) professional management; and (g) international markets.

Merits of multinationals are: (a) employment generation; (b) foreign capital; (c) advanced technology; (d) growth of domestic firms; (e) improved inflow of foreign currency; (f) standard of living; (g) managerial revolution; (h) world economy; and (i) healthy competition.

However, multinational are criticised world over on the following grounds: (a) disregard of national priorities; (b) obsolete technology; (c) excessive remittance; (d) creation of monopoly; (e) restrictive clauses; (f) threat to national sovereignty; (g) alien culture; and (h) depletion of natural resources.

EXERCISES

Short Answer Type Questions

1. Outline the fields of business fit for state ownership and control.
2. In what way public sector enterprises are different from the private sector units. Do public sector units need different organisational form than private sector units?
3. What are the merits and limitations of the departmental undertakings of public sector enterprises?
4. What do you mean by public corporation. What are its main features?
5. Define 'Government Company' and explain its main features?

Long Answer Type Questions

1. Discuss the rationale of public sector enterprises.
2. Public sector enterprises have played vital role in the economic development of India. However, government of India vigorously pursues the policy of disinvestment of such units. What is the rationale of disinvestment at this time?
3. What motivates a company to go global? What are its limitations?
4. Define multinational corporation and explain major features and limitations of such organisations.

Project Work

Title	:	Changing role of public sector enterprises in India.
Objective	:	To encourage students to understand the changing role of public sector enterprises in India.
Coverage	:	Defence requirements, basic and heavy industries, public utilities, preventing concentration of economic power (monopoly), infrastructure, curbing wasteful expenditure, development of backward regions, model employer, contributing to exports and generating foreign exchange.
Material	:	Articles, clippings, news-items, editorials from newspapers, periodicals, journals, etc.
Methodology	:	Each student will collect one write up, clipping or article on any of the issues mentioned above. She/he will give presentation in the class and try to answer the following questions: (a) Is the role of public sector (on the specific issue that she/he selected for presentation) changing? (b) If so, what factors led to this change?

CHAPTER 7

Formation of a Company

LEARNING OBJECTIVES

After studying this chapter, you should be able to :

- identify the stages in the formation of a company;
- describe the function of promoters;
- list the documents required for the incorporation of a company;
- distinguish between memorandum of association and articles of association;
- appreciate the nature and importance of prospectus.

7.1 Introduction

As discussed earlier in Chapter 5, a Joint Stock Company is a legal entity. Whereas the sole proprietorship or partnership forms of business organisations may or may not be registered Joint Stock Company has to follow certain specified legal procedures for its formation. The entire process of the formation of a company, the running of a company and even its winding up have to follow legal directives and formalities.

7.2 Formation of a Company

A company comes into existence after a series of steps have been taken. The steps involved in the formation of a company are as follows:

(i) Promotion;
(ii) Incorporation or registration;
(iii) Commencement of business.

7.2.1 Promotion of a Company

As discussed in Chapter 5, a company being an artificial person, requires somebody to conceive an idea and take decisions about its size, type, structure etc. Those responsible for taking such decisions are called promoters.

Definition of a Promoter

The person or group of persons, who identify a business idea and initiate the process of forming a company to give practical shape to the idea are known as promoters. The promoter conceives the idea of a business

Company Legislation in India

The first legislation enacted for the registration of Joint Stock Companies in India was the Companies Act, 1850. This Act recognised companies as distinct legal entities but did not introduce the concept of limited liability. The concept of limited liability was recognised in India for the first time by the Companies Act, 1857, following the English Companies Act, 1856, in this regard. However, the Act of 1857 did not permit liability of members of banking companies as well. Thereafter, the Companies Act, 1866 was passed for consolidating the law relating to incorporation, regulation and winding up of trading companies and other associations. The Act of 1866 was recast in 1882 and continued to be in force till it was replaced by the Companies Act, 1913. The Act was amended several times and extensively amended in 1936 on the lines of the English Companies Act, 1929. At the end of 1950, the government of India appointed a committee under the Chairmanship of Shri H.C. Bhabha to examine the existing Company Law in the light of its bearing on the development of Indian trade and industry. Based largely on the recommendations of the Company Law Committee, a Bill was presented in Parliament for the Companies Act, 1956, the major changes that the Act of 1956, introduced, among other things, included the law relating to promotion and formation of companies. The Act has since been amended a number of times, and is likely to be replaced by a new legislation.

enterprise, he analyses its prospects and works out a tentative scheme for setting up the organisation. She/he brings together the men, materials, machinery, money and managerial ability to set up the enterprise. A promoter may be an individual, a firm, an association or even a company. An existing business organisation could also be a promoter.

Types of Promoters

Promoters may be classified into the following categories:

(i) Professional promoter: A professional promoter is one who promotes the companies and then hands over the control and management to the Boards of Directors. Her/his interest lies only in the process of promoting companies.

(ii) Occasional promoter: She/he promotes companies once in a while. It is not his regular activities unlike the professional promoter. Once the task is accomplished she/he returns to her/his original occupation.

(iii) Entrepreneur promoter: One who conceives the idea of a new

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Promotion of a Company

Coffee – Instant : Nobody knows who discovered coffee — it could have been an Ethopian goat herd called Kaldi, around 850 AD, who found his goats getting very lively after eating the berries of a particular bush.

A coffee extract in the form of a liquid was produced from about 1840, but the first powdered instant coffee was made by Satori Kato, a Japanese chemist living in America, in 1901. Five years on, an American chemist, G. Washington, produced what he called *a refined soluble coffee*, which was used considerably by the US Army in the First World War.

Modern Instant Coffee: It was produced by the Nestle company, of Vevey, Switzerland, in 1938 — and they called it Nescafe. The idea of turning coffee beans into a soluble powder had been suggested to them first by the Brazilian Institute of coffee in 1930 and it took the firm 8 years to get the process right.

Non-Stick Pan : Roy Plunkett, of the Du Pont Company of America, discovered a plastic called poly-tetrafluor-ethylene in 1938, while working on something else. It turned out to be a good insulator against electricity, was not affected by heat or cold, and was very slippery.

In France, an angler called Mark Gregoire tried out some of this plastic to see if it would prevent his fishing line from sticking. It did! Having succeeded, his wife told him to put some of it on to her cooking pans to prevent food from sticking to them. He did just that and in 1955 founded the Tefal Company.

The same plastic is now known as Teflon, Fluon or Hostaflon.

Source : Book of Knowledge: Who Invented, Discovered, Made the first..., Kenneth Ireland, *Gaurav Publishing House, New Delhi.*

business unit, does the groundwork to establish it and subsequently becomes a part of the management is known as an entrepreneur promoter.

(iv) Financier promoter: A financial institution at times, may undertake the promotion of a company. It is considered suitable for this role owing to its experience in the financial sector.

Functions of a Promoter

The functions of a promoter may be outlined as follows:

(i) Discovery of a business idea: Invariably it is the promoter who conceives the idea of setting up a business. The promoter identifies the areas of profitable avenues of investment. She/he is able to make an assessment of the viability of a particular business. She/he undertakes all the preliminary work in relation to the analysis of opportunities, the amount of capital required and the risk involved.

(ii) Detailed investigation: As a follow up of the preliminary exploration, the promoter undertakes a detailed investigation of all aspects of the business she/he intends to start. To assist her/him in this venture, she/he may seek the help of specialists, such as Chartered Accountants, Cost Accountants, Engineers, organisations involved in market research and other specialised agencies. Thus, she/he may have a better understanding of the cost, profitability, production processes, demand for a product etc. The assistance of the specialists is sought primarily to derive the benefits of specialisation. Specialists are in a position to make an objective analysis of their own areas, which may be of immense help to the promoter. Decisions have to be taken regarding the size, location, layout, etc. Plans are also to be made for the procurement of manpower.

(iii) Assembling of resources: Once the promoter is convinced of the feasibility and the viability of the project (based on investigations) she/he moves towards giving the idea a practical shape. Assembling of resources involves making contracts for the purchase of material, land, machinery, etc.

(iv) Preparing preliminary documents: The promoter will have to take steps to prepare the necessary documents which are compulsory under law for obtaining the certificate of incorporation and certificate for commencement of business of a company. The documents are:

- The *Memorandum of Association* to define the objectives and activities of the company;
- The *Articles of Association* to lay down rules regarding the administration and internal management of the company; and
- The *Prospectus/Statements*, which includes inviting the public to subscribe to its shares capital or statement in lieu of prospectus.

(v) Entering into preliminary contracts: The promoters enter into

Discovery of an Idea

Cash Register : It was invented simply due to the owner of a shop becoming alarmed at the stealing of money by his salesmen but couldn't find a sure way of stopping them or even catching them.

James Ritty of Dayton, Ohio, USA, got the idea of how to solve his problem while he was on board a ship and saw the machine which was used to record the speed of the ship's propellers. On his return, he at once set about inventing his machine, and put it to use in his shop.

In 1884, realising that many other shops had the same problem with some of their employees, after improving his original design, he formed the National Cash Register Company.

The machines went on sale and his fortune was made.

Carpet Sweeper : Suffering from headaches, Melville Bisselle of Michigan, USA, blamed the dust from the straw used to pack crockery in his China shop. What he needed, he decided, was something which would sweep up the straw without causing dust.

So in 1876, he invented a sweeper with a brush roller. The roller was held in place by springs so that it would move according to the pressure on the handle, brushing all the loose straw and dust into a container. It was so effective that he and his wife formed the Bissel Carpet Sweeper Company, because they realised what worked on a floor in a China shop would be a boon in the home.

The Bissell became enormously popular all over the world and became the basis of the later invention of the vacuum cleaner.

Vacuum Flask — Thermos : The vacuum flask started out purely for scientific use. Sir James Dewer needed a container to use in his laboratory to keep very cold liquids, such as liquid air, cold for long periods.

In 1892, he invented a glass container with double walls and a space between them, pumped out the air to create a vacuum and then sealed the empty space — because he knew that heat could not pass through a vacuum. To make extra sure, he had a mirror surface put on the inside of the two layers of glass wall to reduce any possible escape of the cold by radiation.

In 1904, Reinhold Burger, a German, saw Dewer's flask and realised that what kept liquids cold would also keep them hot in exactly the same way. Also, it could be used in people's homes as well as in laboratories.

He offered a prize for the best name to call it, and Thermos (Greek for *hot*) won. The Thermos flask was filled into a container with a stopper and a drinking cup and went on sale and has been selling ever since. A business venture had started and a company was formed.

Source : Book of Knowledge: Who Invented, Discovered, Made the first..., Kenneth Ireland, *Gaurav Publishing House, New Delhi.*

contracts with different parties before the incorporation of the company. The company after its incorporation generally, approves of these contracts. In case the company does not approve of these contracts after incorporation, the promoter is personally liable for these contracts.

(vi) Naming a company: The promoter has to select a name for the company. It should be ensured that the selected name is not the same name or identical to the name of an existing company.

(vii) Appointment of bankers, brokers, solicitors and underwriters: The promoter makes all these appointments. These appointments are to be ratified by the company after incorporation.

Promotion, thus, is an activity involving the discovery of a business opportunity, conducting preliminary investigations, assembling of various resources needed for production, completing the necessary legal formalities.

Legal Status of a Promoter

The promoter performs all necessary functions relating to the establishment of the company as a going concern. But she/he is neither an agent of the company nor trustee of the company. The promoter is not an agent of the company, because a non-existent principal (company yet to be incorporated) cannot have an agent. This indicates that a promoter would be personally liable for the preliminary contracts, if they are not ratified by the company after incorporation.

The promoter is also not a trustee of the company, but she/he must observe good faith in the promotion of the company. She/he should not make any secret gains out of the dealings, and if so, such gains are to be disclosed. For instance, suppose a promoter enters into a contract for the purchase and installation of machinery at an estimated price, but at the time of installation, there is a drastic reduction in price as a result of the duty and tax structure thereby resulting in a saving. The saving being a profit must be disclosed to the company.

7.2.2 Incorporation of a Company

Incorporation of a company is the second stage in the formation of a company. Incorporation refers to the registration of the company as a body corporate under the Companies Act, 1956. The following steps are required to be taken for the purpose is required under law:

(i) Approval of name: Prior to registration of any company, it is necessary to obtain approval of the Registrar of Companies for the proposed name of the company. A set of three names are to be suggested in order of priority. The company may adopt any name, which is not prohibited and does not resemble the name of an existing company.

(ii) Filing of necessary documents: Once approval of name

is obtained, the following documents have to be filed:

(i) Memorandum of Association;
(ii) Articles of Association;
(iii) Statement of Authorised Capital;
(iv) A list of directors with their names in full, addresses, occupations and age;
(v) The written consent of the directors to act as directors;
(vi) Notice of address of the registered office;

How to Form a Company

Step No.	*Details*
1.	Consult the latest edition of the Directory of Companies and Supplements updating it and the guidelines issued by the Department of Company affairs.
2.	Select in order of preference three names.
3.	Apply to the concerned Registrar.
4.	Ensure the availability of a name, or apply again or make an appeal against refusal.
5.	Get drafts of the Memorandum of Association and Articles of Association prepared.
6.	Get the drafts of Memorandum and Articles vetted by the Registrar.
7.	Get the Memorandum and Articles printed.
8.	Get the Memorandum and Articles stamped.
9.	Get the Memorandum and Articles signed by at least 2 members (Private Company) or 7 members (Public Company).
10.	Get the consent of the person willing to act as directors.
11.	Give notice of the situation of the company, alternatively such notice may be given within 30 days of the incorporation of the company.
12.	Provide particulars of Directors, Managers or Secretary, alternatively such notice may be furnished within 30 days of incorporation of the company.
13.	Get the statutory declaration signed.
14.	File the requisite documents such as, Memorandum of Association, Articles of Association, consent of directors, power of attorney, copy(ies) of the agreement(s).

(vii) A statutory declaration that all the necessary requirements of the law for registration have been duly complied with.

(iii) Payment of the requisite fee: The prescribed registration fee and stamp duty must be paid along with the filing of the above documents. The registration fee varies with the amount of authorised capital as explained later.

(iv) Registration: The Registrar of Companies after scrutinising the documents will enter the name of the company in his register. This will be done only if the Registrar is satisfied that all is in order with respect to the compliance of legal formalities.

(v) Certificate of incorporation: After registration, the Registrar of Companies will issue a Certificate of Incorporation. From the date of issue of the Certificate of Incorporation the company becomes a distinct legal entity with a perpetual succession and common seal.

7.2.3 Commencement of Business

A private company can commence its business after receiving the certificate of incorporation, but a public company has to obtain a certificate to commence business after filing the following documents with the Registrar of Companies.

(i) Prospectus or statement in lieu of prospectus: A public company must file a copy of the prospectus or a statement in lieu of prospectus with the Registrar of Companies.

(ii) Minimum subscription: A public limited company cannot make allotment of shares unless a minimum subscription has been received. The company has to file a declaration that the amount of minimum subscription has been received in cash. The amount of minimum subscription (90 per cent of the issued amount as per the Securities and Exchange Board of India (SEBI) guidelines) must be raised within 120 days from the date of issue of the prospectus. In case, it is not raised, the company must return to the applicants whatever amount it has raised within the next 10 days (that is 130 days from the date of issue of prospectus).

(iii) Qualification shares: It is compulsory for all the directors of a public company to subscribe for a minimum number of shares as qualification shares and make necessary payment in this regard. It ensures that a proposed director becomes a shareholder before he becomes a director. The company must make a declaration to this effect.

(iv) Return of allotment: The company is also required to submit a return of allotment to the Registrar containing the names and addresses of shareholders and the number of shares allotted to each.

(v) Declaration: A declaration to the effect that the company has applied for, or obtained permission for its shares to be dealt with on a recognised stock exchange is to be filed.

(vi) Statutory declaration: A statutory declaration from any director or the secretary of the company or an advocate is to be filed stating that the necessary legal formalities have been complied with.

The Registrar will then issue a certificate for commencement of business. This is issued when he is satisfied that the above documents are all in order. The company can start its business from the date of issue of the certificate.

7.3 Documents Used in the Formation of a Company

There are two basic documents, which are required to be filed with the Registrar of Companies in the formation of a public company. These are:

(i) Memorandum of Association;
(ii) Articles of Association.

7.3.1 Memorandum of Association

The Memorandum of Association is the principal document of a company. It lays down the powers and objects of the company as well as the scope of operations of the company beyond which it cannot operate. It can be altered only in the mode and to the extent for which express provisions have been made in the Companies Act. It is the supreme document the provisions of which have an overriding effect over the provisions of other documents.

The purpose of the Memorandum of Association is to enable the shareholders, creditors and others, who deal with the company to know what its permitted range of activities are. It is, in fact, considered as the foundation on which company is based. Its importance lies in the fact that a company cannot undertake those operations, which are not listed in its memorandum.

Contents of Memorandum

The Memorandum of Association contains the following clauses:

(i) Name clause: Under this clause, the name of the company is stated. Any suitable name may be chosen subject to the following restrictions:

(a) The word *Limited* or *Private Limited* must be the last word in the name of every public or private limited company, limited by shares respectively.
(b) The proposed name should not be identical or similar to the name of another existing company.
(c) The proposed name should not convey any connection or link with a government department or local authority.
(d) The government may permit a company to be registered with a limited liability without the addition of the word *Limited* to its name when an association is about to be registered as a Limited Company :
   - for the promotion of art, culture, science, religion, charity or any other useful object;

- it does not propose to pay dividends to members, but to apply its profits or income if any, in promoting its objects only.

(ii) Situation (Registered Office) clause: This clause contains the name of the state in which the registered office of the company is to be situated. This is required in order to fix the domicile of the company i.e., the place of registration. Further, every company must have a Registered Office from the day it begins to carry on its business or within 30 days of its incorporation, whichever is earlier, to which all communications and notices may be addressed.

(iii) Objects clause: This clause can be regarded as the core of the Memorandum of Association. It sets out the objects with which a company is formed. It defines and confines the scope of activities of the company. It explains to the members the range of activities of the company for which the capital will be employed. A company can exercise only such powers which are expressly stated therein or as may be implied therefrom including matters incidental to the powers so conferred.

The objects of the company must be legal and very clearly defined. They should not be contrary to the provisions of any law. They must not be immoral, opposed to public policy or fraudulent or offending against the provisions of the Act. All principal objects of the company must be specifically enumerated. A general statement constituting the objects will not be sufficient.

Every company is required to state in the Memorandum of Association its main objects proposed to be taken upon its incorporation and objects incidental or ancillary to the attainment of the main objectives quite separately from its other objects which it is likely to take up subsequently.

(iv) Liability clause: In case of companies limited by shares, the liability of the members is limited to the *amount remaining unpaid or* uncalled on the shares held by them. For example: (suppose) a company has issued shares of the face value of Rs 10 each on which till date only Rs 7 have been called up. In the event of winding up of the company at this stage all shareholders are liable to pay an amount of Rs 3 per share being the uncalled amount (difference between the of shares issued value and the called up value). Assuming that Rs 10 per share have been called, suppose a shareholder holding 2000 shares has not paid the final call of Rs 3 per share. In the event of the winding up of the company the shareholder is liable to pay Rs 6000 as the unpaid amount.

In the case of a *company limited by guarantee* the liability clause will state the amount which every member undertakes to contribute towards the repayment of liabilities over and above the share value in the event of its winding up. The fact that the liability of the members is limited must be mentioned in this clause.

(v) Capital clause: The capital clause of the Memorandum of a company having share capital must state the amount of share capital, with which the company is to be registered, and its division into shares of a fixed amount. The capital with which a company is registered is called the Registered, Authorised or Nominal Capital.

A company can issue only that number of shares which is, for the time being authorised by the Memorandum. The shares may be preference or equity shares.

(vi) Association/Subscription clause: Under this clause the signatories to the Memorandum express their desire and agreement to form a company. They also agree to take the number of shares mentioned against their respective names. Each subscriber to the memorandum has to take at least one equity share.

(vii) Importance of Memorandum of Association: The Memorandum lays down the scope of activities of a company. It describes the main objects of the company as also the other objects. A company can only undertake the activities that are essential to the accomplishment of the objects specified in the Memorandum, or those, which are incidental to it.

If a company does anything that is not provided for in the Memorandum, it will be treated as *ultra vires*, i.e., beyond the legal power and authority of the company. Even the entire body of shareholders cannot validate an ultra vires act and make it binding on the company. To be able to do anything, which is outside the scope of the Memorandum, the company must first amend the Memorandum suitably which can be done after following the prescribed legal procedures.

7.3.2 Articles of Association

The Articles of Association of a company contain the rules relating to the management of the company's internal affairs. The Articles define the duties, rights and powers of the officers and the board of directors. The Articles of Association must be printed, divided into paragraphs and serially numbered. The signatories to the Memorandum of Association must sign it and it must be duly attested. Companies generally, have their own Articles of Association. However, those companies which do not have Articles of Association of their own, may adopt the model set of 99 articles listed in Table A of the Companies Act, 1956.

Contents of the Articles

The Articles of Association generally, contain the provisions relating to the following matters:

(i) The amount of share capital and different classes of shares.

(ii) Rights of each class of shareholders.

(iii) Details of contracts made with different persons.

(iv) Procedure for making allotment of shares.

(v) Procedure for issuing share certificates.
(vi) Procedure for transfer of shares.
(vii) Procedure for forfeiture and reissue of forfeited shares.
(viii) Procedures for conducting meetings, voting, quorum, poll and proxy.
(ix) Procedure for appointment, removal, and remuneration of directors, their duties and powers.
(x) Procedure for declaration and payment of dividend.
(xi) Procedure regarding alteration of share capital.
(xii) Procedure regarding winding up of the company.
(xiii) Matters relating to keeping of statutory books and records.

Changes in Articles of Association

A change in the Articles of Association may be carried out as per the procedure laid down. Such changes, if any, must be compulsorily intimated

Difference Between the Memorandum and Articles of Association

Basis	*Memorandum of Association*	*Articles of Association*
Purpose	Lays down the charter or the constitution of the company.	Provides rules and regulations for the smooth internal management of the company.
Scope	It defines the objects and powers of the company.	It lays down the ways and means to attain the objectives as laid down in the Memorandum.
Status	It is the fundamental document of the company.	It is a supplementary document and subordinate to the Memorandum of Association.
Relationship	It establishes the relationship of the company with the outside world.	It controls the internal relationship between the company and it's members.
Compulsion	The preparation and filing of the Memorandum of Association is compulsory.	Its preparation is not compulsory. A company may adopt Table "A" of the Companies Act.
Legal effect	Acts done beyond the scope of the Memorandum are void.	Acts done beyond the Articles can be ratified by the shareholders.
Alteration	Alterations to this document is a lengthy legal process.	It is relatively easier to amend the Articles.

to the Registrar of Companies. The Articles of Association are subordinate to the Memorandum of Association. In the event of any conflicting provisions in the two documents, the provisions of the Memorandum will supersede the provisions of the Articles of Association.

7.4 Prospectus

Indian Companies Act, 1956, defines a prospectus as *any document (including any notice, circular, advertisement or other documents) that invites deposits or offers from public for the subscription or purchase of any shares in, or debentures of a body corporate.* The term prospectus therefore includes any document, which invites deposits from the public or invites offers from the public to purchase shares or debentures of a company.

The essential elements of a prospectus are as follows:

(i) There must be an invitation to the public at large.

(ii) The invitation must be made *by or on behalf of the Company.*

(iii) The invitation must be *to subscribe or purchase its shares or debentures.*

Importance of Prospectus

The prospectus of a company aims at serving the following purposes:

(i) Prospectus contains the printed summary of the company's past history, if any, it's present status and future prospects.

(ii) It informs the public about the company and invites the people to make an investment in the company.

(iii) It is an authentic record of the terms and conditions on which the shares and debentures are issued.

(iv) It contains/includes business policies and programmes of the company.

Contents of the Prospectus

Prospectus is *the Document* through which the prospective investors can evaluate a company. It must contain the following broad particulars:

(i) Company's name and the address of it's registered office.

(ii) The main object of the company.

(iii) The number and classes of shares, if any, and the nature and extent of the interest of the shareholders in the property and profits of the company.

(iv) The details of redeemable preference shares to be issued, if any, i.e., the date and mode of redemption.

(v) Qualification shares of the directors, if any.

(vi) Any provision in the Articles regarding the remuneration of director(s), managing director(s) or manager.

(vii) The names and addresses of the directors, managing director or manager.

(viii) The *minimum subscription* that is the minimum amount, which, in

the opinion of the directors must be raised by the issue of share.

(ix) The time of opening and closing of the subscription list.

(x) The amount payable on the application and allotment of each class of share.

(xi) Rights, privileges and restrictions attached to each class of share.

(xii) A reasonable time and place at which copies of audited balance sheets and profit and loss accounts of the company may be inspected.

(xiii) Underwriters to the issue.

(xiv) Merchant bankers to the issue.

(xv) Registrars to the issue.

Statement in Lieu of Prospectus

A public company having a share capital may sometimes decide not to approach the public for securing the necessary capital because it may be confident of obtaining the required capital privately. In such cases, it will have to file a *statement in lieu of prospectus with the Registrar of Companies. A statement in lieu of prospectus* is drafted in accordance with the Schedule III of the Companies Act, 1956. It contains information much similar to that of a prospectus. It must be duly signed by all the directors and a copy thereof must be filed with the Registrar of Companies at least three days before the allotment of shares. A private limited company, however, is not required to file either a *prospectus* or a *statement in lieu of prospectus* because it is not permitted to raise funds from the public.

SUMMARY

Formation of a company: A company comes into existence after a series of steps have been taken. The steps involved in the formation of a company are as follows: promotion; incorporation or registration; commencement of business.

Definition of a promoter: The person or group of persons, who identify a business idea and initiate the process of forming a company to give practical shape to the idea are known as promoters.

Types of promoters: Promoters may be classified into the following categories: professional promoter; occasional promoter; financier promoter.

Functions of a promoter: The functions of a promoter may be outlined as follows: discovery of a business idea; detailed investigation; assembling of resources; preparing preliminary documents; entering into preliminary contracts; naming a company; appointment of bankers; brokers; solicitors, and underwriters.

Legal status of a promoter: The promoter performs all necessary functions

relating to the establishment of the company as a going concern. But he is neither an agent of the company nor trustee of the company.

Incorporation of a company: The following steps are to be required for incorporation : approval of name; filing of necessary documents; payment of the requisite fee; registration; certificate of incorporation.

Commencement of business: A public company has to obtain a certificate to commence business after filing certain documents viz. prospectus or statement in lieu of prospectus; minimum subscription; qualification shares; return of allotment; declaration; statutory declaration.

Documents used in the formation of a company: There are two basic documents, which are required to be filed with the Registrar of Companies.

Memorandum of Association: This is the principal document of a company. It lays down the powers and objects of the company as well as the scope of operations of the company beyond which it cannot operate.

Contents of Memorandum: The Memorandum of Association contains the following clauses; name clause, situation (registered office) clause, objects clause; liability clause; capital clause; association or subscription clause.

Changes in the Articles of Association: A change in the Articles of Association may be carried out as per the procedure laid down. Such changes, if any, must be compulsorily intimated to the Registrar of Companies.

Prospectus: Indian Companies Act, 1956, defines a prospectus as *any document (including any notice, circular, advertisement or other documents) that invites deposits or offers from public for the subscription or purchase of any shares in, or debentures of a body corporate.*

Importance of prospectus: The prospectus of a company aims at serving the following purposes: prospectus contains the printed summary of the company's past history, if any, it's present status and future prospects. It informs the public about the company and invites the people to make an investment in the company. It is an authentic record of the terms and conditions on which the shares and debentures are issued. It contains/includes business policies and programmes of the company.

Contents of the prospectus: This is *the Document* through which the prospective investors can evaluate a company.

Statement in lieu of prospectus: A public company having a share capital may sometimes decide not to approach the public for securing the necessary capital because it may be confident of obtaining the required capital privately. In such cases, it will have to file a *statement in lieu of prospectus with the Registrar of Companies.*

EXERCISES

Short Answer Type Questions

1. Who is a promoter?
2. Define minimum subscription.
3. Explain the significance of a prospectus.
4. How can alteration in the Articles of Association be made?
5. What is meant by promotion of a company?
6. What is meant by incorporation of a company?
7. List the documents to be submitted for the registration of a company.
8. What is a Memorandum of Association?
9. What is meant by Articles of Association?

Long Answer Type Questions

1. Discuss the important documents used in the formation of a company.
2. Shri Manoj is interested in floating a company. Discuss the steps he should take.
3. List and explain the various clauses of the Memorandum of Association.
4. Distinguish between the Memorandum of Association and Articles of Association.
5. Discuss the role of promoters in the formation of a company.
6. Discuss the steps for the incorporation of a joint stock company.
7. Define a prospectus and state its main clauses.

Project Work

1. Collect news items, advertisements and circulars from newspapers regarding promotion of a company and make a scrap book. Did you come across any company which was controversial, or any company which did not comply with the Companies Act or SEBI regulations. Find out the anomalies in their promotion by reading related items in newspapers and business magazines.

CHAPTER 8

Sources of Business Finance

LEARNING OBJECTIVES

After studying this chapter, you should be able to :

- state the various types of business finance;
- appreciate the significance of business finance;
- explain the concept of owners funds and borrowed funds;
- discuss the features, merits and limitations of various sources of long term finance;
- identify the international sources of finance;
- analyse the role of financial institutions and non-banking finance companies;
- examine the nature of financial assistance available to industries in rural, backward, and hilly areas.

8.1 Introduction

All economic activities in the modern world centre round the use of finance. The term *finance* means money or funds. Financing means, making money available when it is needed. Business finance refers to money required for business purposes. In this chapter, we shall discuss the various sources of finance available to a company.

8.2 Nature and Significance of Business Finance

No one can start a business or run a business without adequate funds. Whether it be manufacturing or trading activities, business finance is imperative. Every business requires some money to start, which is called initial capital. The amount of capital required depends upon the nature and size of business. Finance required for business activities may consist of owners contribution and borrowings from different sources. Finance is required to start a business, to operate it, as well as for modernisation and expansion.

While starting a business money is needed to procure fixed assets (includes machinery, furniture etc.) and also for meeting day-to-day expenses (working capital). The production process is lengthy and takes time to be completed. Moreover, there is a time gap between production and sales, and this necessitates the need for short term working capital. The importance of finance arises basically due to the time lag between revenue generated through sales and the initial expenditure. The need for short term working capital, is common for all businesses, be it manufacturing or trading. Like manufacturers, traders must also spend money on procurement, transportation and storage of goods well in advance of the actual sales of the goods.

In the case of fixed assets acquired for business purposes, like building, plant and machinery, funds remain locked up for a longer period and there is longer waiting for recovery of the cost of those long lived assets. Availability of finance is therefore, considered essential for day-to-day activities as well as for investment in durable (fixed) assets.

The importance of finance has increased and will continue to increase with the growth of business and industry. This is because large scale production and distribution require considerably large amounts to be invested in business. Even then, the necessity of finance does not come to an end with the commencement of business. Additional funds are needed from time to time for expansion. Furthermore, changing environment of business and increasing competition may require new methods of production or distribution to be adopted, or plant and machinery to be modernised, or new products to be introduced in the market. In the absence of additional investment for such purposes it may be impossible for the business to survive.

Finance plays such a vital role in modern enterprise that it's often said to be the lifeblood of business. Finance is needed at every stage in the life of a business. It must be available at the proper time. It must also be adequate for the purpose for which it is needed. Insufficient funds may affect the growth of the firm adversely.

8.3 Types of Business Finance

We have mentioned above, that funds are required by business firms for different purposes — to acquire fixed assets, to provide for operating expenses, and to improve methods of production. Depending on the nature and purpose to be served, we may distinguish between three types of finance. These are:

(i) Long term finance;
(ii) Medium term finance;
(iii) Short term finance.

(i) Long term finance: Funds which are required to be invested in the business for a long period (say more than five years) are known as long term finance. It is also known as long term capital or fixed capital. This type of finance is used for acquiring fixed assets, such as land, building, plant and machinery, etc. The amount of long term funds required naturally depends on the type of business and the investment required for fixed assets. For example, the manufacture of steel, cement, chemicals, etc. involve heavy expenses to be incurred on buildings, machinery and equipments. A small factory or a small workshop repairing electrical goods will require much smaller investment in fixed assets. On the other hand, traders generally, require smaller amounts for long term investment as compared to the requirement of manufacturers. This is because trading concerns do not require expensive long-lived assets to be used for their activities. The size of the business firm also determines the amount to be invested in fixed assets. Large scale manufacturing and trading activities will obviously require more long term capital than small scale enterprises. Long term finance is required for acquisition of assets and modernisation purposes.

(ii) Medium term finance: Business firms often need funds for a period exceeding one year and not more than 5 years for particular purposes. This is referred to as medium term finance or medium term capital. They may include expenses on modernisation of plant and machinery, or introduction of a new product, adoption of new methods of production or distribution, or an advertisement campaign. The necessity of this type of finance generally, arises on account of changes in technology or increasing competition. Manufacturing industries are more often in need of such finance. The amount required depends on the nature or purpose. The expenditure incurred is regarded as an investment because higher returns are expected out of it.

(iii) Short term finance: This type of finance is required for a short period upto one year. It refers to funds

needed to meet day-to-day requirements and for holding stocks of raw materials, spare parts, etc. to be used for current operations. Short term finance is often called working capital or short term capital, or circulating capital. As soon as goods are sold and funds are recovered the amount is again used for current operations. Generally, speaking, production processes are completed within a year and goods are ready for sale. Hence, short term funds can be used over and over again from year to year.

How much short term finance will be required depends on (a) the nature of business undertaken; (b) the time gap between commencement of production or purchase of goods and their sale; and (c) the volume of business. Trading firms normally require proportionately more of short term capital than long term capital. Manufacturing concerns, on the other hand, need relatively smaller amounts of short term capital as compared to long term capital. Again, if production time and the time-gap between production and sale is shorter (say one or two months), it will require much less short term finance than if the time gap is one year. The volume or scale of business activity also determines the amount of short term finance. Thus, a small factory needs much less short term capital than a large manufacturing enterprise.

8.4 Sources of Finance

The primary responsibility of financing a business venture is that of the owners of the business. However, loans and credits also meet the financial requirements of business firms. In sole proprietorship business, the individual proprietor generally, invests her/his own savings to start with. She/he may reinvest a part of the profits earned in course of time. She/he may also borrow money on her/his personal security or the security of assets. Similarly, the capital of a partnership firm consists partly of funds contributed by the partners and partly of borrowed funds. If necessary they may also decide to reinvest their own shares of profit.

The company form of organisation enables the promoters to raise necessary funds from the public, who may contribute capital and become shareholders of the company. In course of its business, the company can raise loans directly from banks and financial institutions or by issue of debentures to the public. Besides, profits earned may also be reinvested instead of being distributed as dividend to the shareholders.

Thus, for any business enterprise, there are two sources of finance, that is, funds contributed by owners, and funds available from loans and credits. In other words, the financial resources of a business may be provided by owners funds and borrowed funds. Let us examine the characteristics of these two sources:

8.4.1 Owners Funds or Ownership Capital

It may be useful to distinguish between the term funds and the term capital.

Ownership capital consists of the amounts contributed by owners as well as profits. This is because profits ultimately belong to the owners. But the term fund has wider scope and coverage. It includes the profits reinvested in the business, and amounts received from any other inward remittance. The key features of ownership funds are as follows:

(i) Provision of risk capital: One major characteristic of owner's fund as a source of finance is that it provides *risk capital*. It is known as *risk capital* because every business runs the risk of loss or low profits, and it is the owners who bear this risk. In the event of low profits they do not have adequate return on their investment. If losses continue, the owners may be unable to recover even their original investment after meeting the loan obligations. However, in times of prosperity and in the case of a flourishing business the high level of profits earned accrue entirely to the owners of the business.

(ii) Permanent source of capital: The second characteristic of this source of finance is that ownership capital remains permanently invested in the business. It is not refundable like loans or borrowed capital. Hence, a large part of it is generally, used for acquiring long term fixed assets. It is also used to finance a part of the working capital which is permanently required to hold a minimum amount of cash, stocks etc. Besides, this type of finance is available for all purposes throughout the life of the business.

(iii) Separation of ownership and management: Another characteristic of ownership capital relates to the management of business. In case of a company, it is managed by the officers under the control and supervision of the board of directors, who are elected by the shareholders. Although the owners of the company are the shareholders, the responsibility of management does not rest with them.

(iv) No security required: No security of assets is to be offered against ownership capital.

Merits

Arising out of its characteristics, the advantages of ownership capital may be briefly stated as follows:

(i) It provides risk capital, which makes it possible for creditors to deal confidently with the company. Ownership capital forms the basis for raising loans.

(ii) It is a source of permanent capital, i.e., it is not returnable. It is non-refundable until such time that business ceases. Therefore, the company is confident of retaining such amounts to meet any problems and unforeseen contingencies.

(iii) Capital forms the basis on which owners acquire their right of control and supervision over management. The final say in the management of the organisation rests with the owners, who invest money in the business. This in turn ensures that the business is conducted in their best interest.

(iv) Since management is separate from ownership professional managers can be employed to look after the interests of all stake-holders.

(v) Since no security is required for equity, the assets of the company are free to be used for raising loans. Thus, it can be used to enhance the capital base of the firm.

(vi) Unlimited amount of capital can be raised. The capacity of the proprietor of a sole proprietorship firm is extremely limited. In a partnership, capital is limited to the financial capability of the partners. In the case, of a company, a large number of members may participate. Thus, it can generate huge amounts of capital.

Limitations

There are also certain limitations of ownership capital as a source of finance. These are:

(i) Diffusion of control: A joint stock company can raise amounts by issuing shares to the public. But it leads to an increased number of people having ownership interest and right of control over management. This may reduce the original promoter's power of control over management.

(ii) Possibility of under utilisation of ownership funds: Being a permanent source of capital, ownership funds cannot be reduced easily in the case of a company. Share capital is non-refundable as long as the company is in existence. This may mean a part of this fund remaining idle when there is no scope for expansion or fresh investment opportunities.

8.4.2 Borrowed Funds or Borrowed Capital

It includes all funds available by way of loans or credit. Its chief characteristics are:

(i) Time horizon: Loans can be raised by business firms for specified periods at fixed rates of interest. Thus, borrowed funds may serve the purpose of long term, medium term or short term finance.

(ii) Need for security: Borrowing is possible against personal security but generally, it is against the security of assets. Banks and financial institutions give loans against the security of assets. A company can raise loans on different terms and conditions, or by different modes.

(iii) Repayment: Interest on borrowed capital is payable at periodic intervals. The principal amount is to be repaid according to the terms and conditions of the loan. In other words, the borrowing of funds involve two type of liabilities, one is the payment of interest at regular intervals; and the other is the repayment of principal amount. These liabilities have to be met even if the earnings are low or there is loss.

(iv) Control : Ordinarily lenders and creditors do not have any right of control over the management of the borrowing firm. But, they can sue the

firm in a law court if there is default in payment of interest or repayment of loan amount.

Merits

From the business point of view, borrowed capital has several merits:

(i) It does not affect the owners' control over management.

(ii) Interest is treated as an expense, so it can be charged against income and the amount of tax liability is thereby reduced.

(iii) It provides flexibility to the capital structure. Finance may be raised when it is required and repaid when it is not required, according to convenience and needs.

(iv) A fixed rate of interest is to be paid even when profits are very high. With a given rate of return, since the rate of interest remains fixed, the balance of profit belongs to the shareholders. Thus, the owners may enjoy a much higher rate of return on investment than the lenders.

Limitations

Against the above merits, borrowed capital has certain limitations:

(i) Fixed liability: Payment of interest and repayment of loans cannot be avoided even if there is no profit. Default in meeting these obligations may create problems for the business. To begin with business may suffer on account of decline of its credit worthiness. Continuing default may even lead to insolvency of the firm.

(ii) Adequate security: It requires adequate security to be offered against loans. Borrowed funds are usually, available upto 80 per cent of the value of assets, depending on the nature and value of the asset.

We have discussed the characteristics of ownership capital (owners' funds) and borrowed capital (creditors' funds) as sources of business finance. Whether it is a trading or manufacturing concern, a proprietary, partnership or company form of organisation, owners' funds and borrowed funds are taken together to meet the financial needs of business enterprises. We have stated earlier that the company form of organisation is best suited for undertaking large scale business. This is mainly because a company is in a position to raise much larger amounts of capital than a proprietary or partnership firm. We shall now discuss the various sources which may be adopted by a company to raise both ownership capital and borrowed capital.

8.5 Sources of Company Finance

The sources of long term finance include:

(i) Issue of shares;

(ii) Issue of debentures;

(iii) Loans from financial institutions;

(iv) Retained profits; and

(v) Public deposits.

Let us examine the characteristics and implications of each of the long term sources.

(i) Issue of shares: The amount of capital decided to be raised from members of the public is divided into units of equal value. These units are known as *shares* and the aggregate value of shares is known as *share capital* of the company. Those who subscribe to the share capital become members of the company and are called *shareholders*. They are the part owners of the company. Hence, shares are also described as *ownership securities*.

Two types of shares may be issued by a company to raise capital: (a) equity shares; and (b) preference shares.

(a) Equity shares : The amount raised by the issue of equity shares is known as *equity share capital*, it is the most important source of raising long term capital for a company. Equity capital represents ownership capital as equity shareholders collectively own the company. They enjoy the reward as well as bear the risk of ownership. There is no promise to shareholders of a fixed dividend. The liability is generally, limited to the amount agreed to be subscribed by the shareholders.

Equity share capital may be (i) with equal rights; or (ii) with differential rights as to dividend, voting or otherwise. This has been permitted after an amendment to the Companies Act in 2000. Prior to this, public companies were not allowed to issue equity shares with differential rights.

Equity shares have the following distinct characteristics:

(i) The holders of equity shares are the primary risk bearers. It is the issue of equity shares that mainly provides *risk capital*. This implies that in case the company suffers losses and has to be closed down, the equity shareholders may lose the entire amount they had invested. Creditors' dues must be met before any payment is made to the preference or equity shareholders.

(ii) Equity shareholders have a residual claim in the firm. In other words, the income left after satisfying the claims of all creditors, outsiders, and preference shareholders, belongs to equity shareholders.

(iii) Equity shareholders are likely to enjoy a higher profit as well as higher increase in the value of the shares.

(iv) Equity share capital is the basis on which loans can be raised. It provides credibility to the company and confidence to the loan providers.

(v) Since equity shareholders have the right to vote for the election of the board of directors, collectively they ensure that the company is managed in the best interests of the shareholders.

Merits

From the company's point of view, there are several merits of issuing equity shares to raise long term finance.

(i) It is a source of permanent capital without any commitment of a fixed

return to the shareholders. The return on capital depends ultimately on the profitability of business.

(ii) It facilitates a higher rate of return to be earned with the help of borrowed funds because loans carry a fixed rate of interest. Hence, equity shareholders are likely to enjoy a higher rate of return based on profitability.

(iii) It is on the basis of equity share capital that loans can be raised. Equity provides the credibility to the company and confidence to the prospective loan provider.

(iv) Democratic control over management of the company is assured due to the voting rights of equity shareholders.

Limitations

Although there are several advantages of issuing equity shares to raise long term capital, there are certain limitations also of this source of finance:

(i) Equity shares have the risk of fluctuating returns and the risk of fluctuating market value of shares. In times of adversity, there may be low returns or even no returns.

(ii) Equity share capital is a permanent source of finance. It cannot be refunded during the life of the company. When there is no scope for expansion or new investment during periods of economic depression, the equity capital may remain idle, the rate of return may be reduced since there is no commitment to pay and no fixed obligations to be met on equity capital, there is always the possibility of putting it to sub optimal uses.

(iii) Issue of additional equity shares to raise funds for expansion poses a threat to the existing shareholders as regards their power of control over management of the company. Existing shareholders are generally, offered the new issue of shares and in case they decline, the shares are offered to the public. New shareholders may exercise their voting rights against the continuation of existing directors.

(iv) There are too many procedural delays and too many time consuming formalities to be completed before any public issue of shares can be made.

(v) An equity issue cannot be made any time the company wants. It depends on market conditions. These generally, determine the time of issue of shares and the value of the shares.

A new variant of equity shares that have recently been introduced are sweat equity shares. These are shares issued at discount or for consideration other than cash, for providing know how or intellectual property rights or value additions.

Source : Company Law Text

(b) Preference shares: The amount of share capital which is raised by the issue of preference shares is called *preference share capital*. It is referred to as *preference shares* as the owners of these shares have a preferential claim over dividends and repayment of capital. Preference shares represents a hybrid form of financing in that, it consists of some characteristics of equity shares and some attributes of debentures. It resembles equity shares in the following ways: (i) preference dividend is payable only out of profit after tax; (ii) the payment of preference dividend is entirely within the discretion of directors. It is not an obligatory payment, even if there is a profit. It resembles debentures because it gets a fixed rate of return.

Preference shares have the following distinct characteristics:

(i) Preference shareholders have the right to claim dividend out of profits at the fixed rate, which is decided according to the terms of issue of shares.

(ii) Preference shareholders have also the preferential right of claiming repayment of capital in the event of winding up of the company. Preference capital has to be repaid out of assets after meeting the loan obligations and claims of creditors but before any amount is repaid to equity shareholders.

Different kinds of preference shares may be issued as:

(i) Cumulative or non-cumulative;
(ii) Participating or non-participating;
(iii) Redeemable or non-redeemable;
(iv) Convertible cumulative preference shares.

In the case of *cumulative* preference shares, if dividend cannot be paid due to inadequate profits in a particular year the arrears of dividend accumulate and become payable in subsequent years when profits are adequate. *Non-cumulative* preference shares have no such provision.

If the shareholders, in addition to the fixed rate of dividend, are entitled to a further share in the surplus profits after a reasonable dividend has been paid to equity shareholders, the shares are known as *participating* preference shares. Where the terms of issue do not provide for it, the shares are known as *non-participating* preference shares.

Redeemable preference shares are those which the company undertakes to redeem (that is, repay) after a specified period. Where there is no such undertaking, the shares are called *irredeemable* preference shares. However, these shares can also be redeemed by the company after specified period by giving notice as per the term of issue. It may be noted that companies are no longer permitted to issue irredeemable preference shares.

A company may decide to issue a type of cumulative preference share which can be converted into equity share. These are known as *convertible* cumulative preference shares. Under present rules in India conversion of such shares can be decided to be made

between the end of one and 5 years. In India preference shares usually, are cumulative with reference to dividends.

Merits

Issue of preference shares as a source of finance is preferred by many companies due to the following reasons:

(i) It helps to enlarge the sources of funds as some financial institutions and individuals prefer to invest in preference shares due to the assurance of a fixed return. This helps the company to attract investors.

(ii) Dividend is payable only when there are profits. There are no fixed liabilities as is the case with loans and borrowings.

(iii) A higher return is possible if the company is in good times, in the case of participating preference shares.

(iv) It does not affect the equity shareholders control over management.

(v) The rate of preference dividend is fixed. Hence, in years of prosperity, the rate of return on equity capital is likely to be higher than it would be otherwise, due to preference share capital.

Limitations

The limitations of preference shares relate to some of its main features:

(i) Dividend paid cannot be charged to the company's income as an expense; hence, there is no tax saving as in the case of interest on loans.

(ii) Issue of preference share does not attract many investors as there is no assured return, and the return is generally, low and lesser than the rate of interest on loan.

(iii) The holders of preference shares have a right to vote on any resolution of the company directly affecting their rights, which includes any resolution for winding up the company, repayment or reduction of its share capital, etc.

(ii) Debentures: Debentures are instruments for raising long term debt capital. When a company decides to raise loans from the public, the amount of loan raised from a particular issue of debentures is divided into units of similar value. A debenture certificate is issued by the company to acknowledge its debt. Those who invest money in debentures are known as *debenture holders*. They are creditors of the company. Debentures are, therefore, called *creditorship* securities.

Debentures have the following characteristics:

(a) Debentures carry a fixed rate of interest.

(b) Debentures are redeemable i.e., repayable after a certain period which is specified at the time of issue. They may become due for repayment after a period of 5 years or more.

(c) When debentures are sold to the public and involve a considerable number of persons, a trustee is appointed and a trust deed is formed to convey the property of the company to her/him. The trustee is usually a bank, an insurance company or a financial institution. The trustee is appointed to ensure that the borrowing firm fulfills its contractual obligations.

Depending upon the terms and conditions of issue there are different types of debentures. These are: secured or unsecured debentures, and convertible or non-convertible debentures.

(a) Debentures which are secured by a charge on the immovable properties, of the company are *secured* debentures. Debentures which are not secured by a charge or mortgage of any asset are called *unsecured* debentures. The holders of these debentures are treated as ordinary creditors.

(b) A company may issue debentures which are convertible into equity shares at the option of debenture holders. The ratio of conversion and the period during which conversion can be effected are specified at the time of debenture issue. Such debentures are known as *convertible* debentures. If there is no mention of conversion at the time of issue, the debentures are regarded as *non-convertible* debentures.

Merits

Debenture issue is a widely used method of raising long term finance by companies. This is due to the following merits:

(i) The cost of debt capital, represented by debentures is lower than the cost of preference or equity capital. This is because the interest on debentures is tax deductible and hence, it helps in increasing the rate of return. Thus, debenture issue is a cheaper source of finance.

(ii) Debenture financing does not result in dilution of control of equity shareholders, since debenture holders are not entitled to vote.

(iii) The fixed monetary payment associated with debentures is interest. This fixed return appeals to many investors, since they are not affected by the fluctuating fortunes of the company.

(iv) Funds raised by the issue of debentures may be used in business to earn a much higher rate of return than the rate of interest. As a result, the equity shareholders earn more.

Limitations

We have noted above the advantages of debenture issue as a source of finance. But, it has certain limitations also:

(i) It involves a fixed commitment to pay interest regularly and fixed obligation to pay the amount when it is due on the part of the company.

(ii) This liability must be discharged even if the company has no earnings. The burden may be difficult to bear in times of falling profits.

(iii) Retained profits: Retained earnings are the undistributed profits after payment of dividends and taxes, commonly referred to as reserves and surplus. They represent the internal sources of finance available to the company. The company's use of surplus or free reserves, is termed as *ploughing back of profits*. It provides the basis of financial expansion and growth of companies. It is considered as a very important source of funding. Since it is internally generated, this method of financing is known as self financing. The retained earnings serve many purposes :

(a) They provide a cushion of security in times of adversity, which the company can fall back upon.
(b) In certain industries such as pharmaceuticals research and development activities are of vital importance. Constant innovation and new products are essential for survival. Funds for these purposes can be available out of retained profits.
(c) Finance for new projects and expansion plans are sometimes required to enter new forays which are important areas for the future. Retained profits prove useful such times.

Since profits belong to the shareholders, retained profit is considered to be an ownership fund. It serves the purpose of medium and long term finance. The total amount of ownership capital of a company can be determined by adding the share capital and accumulated reserves. Companies may convert reserves and surplus into share capital by issuing bonus shares. From the company viewpoint, bonus shares are issued free of cost and do not result in any outflow of cash. Investors too are benefited by the issue of shares free of cost.

Merits

This source of finance has the following advantages:

(i) As an internal source, it is more dependable than external sources. It does not depend on the investors' preference and market conditions.
(ii) Use of retained profit does not involve any cost to be incurred for raising the funds. There are no expenses on prospectus, advertising, etc.
(iii) There is no fixed commitment to pay dividend on such funds.
(iv) Control over the management of the company remains unaffected as there is no addition to the number of shareholders.
(v) Unlike debentures, no charge is created against the assets and no restrictions are put on the management.
(vi) Retained earnings add to the financial strength and improved credibility of the company. A

company with large reserves can face unforeseen contingencies, trade cycles and any other crisis.

Limitations

Use of retained earnings may result in the following drawbacks:

(i) The management of a company may not always use the retained earnings in the best interest of shareholders. It may misuse them by investing in unprofitable or undesirable channels. Excessive reserves may make the management wasteful and extravagant.

(ii) Large retention of earnings over a long period of time may cause dissatisfaction among shareholders as they do not receive the expected rate of dividend.

(iii) If the quantum of retained earnings is too high, the management may issue bonus shares to equity shareholders. Frequent capitalisation of reserves may result in over capitalisation.

(iv) Public deposits: These are unsecured deposits invited by companies from the public mainly to finance working capital requirements. Public deposits can be invited by companies for a period of 6 months to 3 years as per rules. However, they can be renewed from time to time. Though, they are primarily sources of short term finance, the renewal facility enables them to be used as medium term finance.

Fixed deposits are simple to raise. A company intending to invite deposits simply has to advertise in the newspapers. Any member of the public can fill up the prescribed form and deposit the money with the company. The company in return issues a deposit receipt which is an acknowledgement of debt by the company. The terms and conditions of the deposit are printed on the back of the receipt.

Earlier interest rates were subject to a ceiling. But now, interest rates are in tune with the market trends but generally, public deposits pay out a higher rate than the interest rate on bank deposits. The rate of interest on public deposits depends on the period of deposit and reputation of the company.

Since these deposits are unsecured, a company which has public deposits is required to set aside, as deposit or investment, in the current year an amount equal to 10 per cent of the deposits maturing by the end of the year. The amount so set aside can be used only for repaying such deposits. Public deposits cannot exceed 25 per cent of share capital and free reserves.

Merits

The merits of public deposits are the following:

(i) The procedure for obtaining public deposits is much simpler than equity and debenture issues. Thus, there are fewer administrative costs for deposits.

(ii) **Public deposits** are unsecured. Thus, the assets are free to be used as mortgage in future, if need arises.

(iii) Interest paid on public deposits is tax deductible. Hence, it helps in bringing down the tax liability.

(iv) Public deposits introduce flexibility in the financial structure of the company. This is because the deposits can be repaid when they are not required.

(v) There is no dilution of shareholders' control because the depositors have no voting rights.

Limitations

Raising finance through public deposits suffers from the following limitations:

(i) The amount of funds that can be raised by way of public deposits is limited, because of legal restrictions.

(ii) The maturity period is relatively short. The company can not depend on them for long term financing requirements.

(iii) Public deposits are an uncertain and unreliable source of finance. The depositors may not respond when conditions in the economy are uncertain. Also, deposits may be withdrawn whenever, the depositors feel shaky about the financial health of the company.

8.6 International Sources of Finance

Prior to 1991, the Indian financial system was insulated from the international financial markets. Indian companies could only access the Indian capital markets, that is, their sources of finance were restricted within India. With the advent of economic liberalisation, an openness was introduced in the financial system. Indian companies now have the option of accessing the global capital markets. They can tap international sources of finance for both debt and equity. The main instruments used by Indian companies to tap international sources of equity are Global Depository Receipts (GDRs) and American Depository Receipts (ADRs).

8.6.1 Global Depository Receipts (GDRs)

GDRs are issued to tap the global capital markets by way of global equity offerings. However, these are indirect equity offerings and the shares issued by the firm are held by an international bank referred to as a depository. This bank receives dividends, notices and reports and issues negotiable certificates as claims against these shares. These claims are the GDRs and such shares are depository shares. GDRs are non-voting equity holdings. In short, GDRs are dollar-denominated instruments usually, representing a certain number of equity shares denominated in rupees.

8.6.2 American Depository Receipts (ADRs)

ADRs are similar to GDRs as they too are used to tap overseas investors. Like

GDRs they are global equity offerings. Like GDRs the shares issued by the company are held by an international bank (the depository), which receives dividends notices, and reports.

Though GDRs and ADRs are similar in many respects but they also have their points of differences. ADRs carry more clout with investors as they are listed on one of the major stock exchanges in the US. Since stock exchange regulations are extremely stringent in the US, ADRs are subject to much stricter disclosure requirements than GDRs. Also the annual legal and accounting costs of maintaining an ADR are much higher.

8.6.3 Foreign Direct Investment (FDI)

International finance also comes in the form of Foreign Direct Investment (FDI). This is direct contribution to the equity capital of the company by multinational companies. A large number of companies have expanded their operation beyond their national boundaries. These companies are known as multinational corporations (MNCs). Investment in the overseas operation of the MNCs is represented by foreign direct investment. It includes:

(i) Investment for establishment of a new enterprise in foreign country either as a branch or as a subsidiary;

(ii) Expansion of an overseas branch or subsidiary; and

(iii) Acquisition of an overseas enterprise.

Prior to July 1991, FDI was permitted in India only on a case to case basis with a normal courting of 40 per cent of the total equity capital. A higher percentage was permitted in case of high-tech import area and export oriented units. In the new economic environment, the government has liberalised the rules pertaining to FDI. The ceiling of 40 per cent has been increased and in certain cases even 100 per cent of foreign equity is permitted. There is automatic approval in certain high priority areas, and also FDI has been delinked from technology transfer.

Overall, a sea change has occurred in the Indian financial system with regard to its integration with the global financial markets. There is an increasing trend towards accessing the

> The first Indian company to access the international capital market was Reliance Industries when it sold $150 million worth of GDRs in 1992. Since 1992 more than 60 Indian companies have raised almost $ 7 billion. VSNL's GDR Issue was the largest ($ 527 million), followed by MTNL ($ 418 million) and Ashok Leyland ($ 137.7 million).
>
> Besides, Hindalco, SAIL, Larsen & Toubro, CESC, BSES, Arvind Mills and Bajaj Auto among others have successfully made GDR issues.

global capital markets. And a similar initiative to invite global capital into India.

8.7 Institutional Finance

Institutional finance refers to institutional sources of finance to industry, other than commercial banks. These financial institutions or financial intermediaries act as a link between savers and investors, but are distinct from commercial banks. These financial institutions offer finance and financial services in areas which are outside the purview of traditional commercial banking. The term institutional finance generally, includes:

- Finance provided by Public Financial Institutions (PFIs);
- Finance provided by Non Banking Finance Companies (NBFCs);
- Finance provided by Investment Trusts and Mutual Funds (ITMF).

Each of the above mentioned categories are by themselves prominent sectors of the financial system, and will have to be understood, somewhat in detail.

8.7.1 Public Financial Institutions

Public financial institutions are also referred to as term lending institutions, development banks or simply financial institutions. After India attained independence, it was realised, specialised institutions were needed to accelerate development of the country. Thus, development banks were established with the core objective of financing projects, aimed at bring rapid industrialisation and cater to the long term financing needs of the industrial sector. Development banks differ from, commercial banks in several respects. In fact, they had to be established because of the inadequacies of the existing financial intermediaries and banking institutions. Commercial banks provide credit for short term requirements. They focus on the working capital need of trade and industry. Development banks provide finance for medium and long term needs. As the name suggests, the entire focus of these banks is the development of industrial units with the ultimate aim of industrial development of the country. For this reason, they provide finance for investment in fixed assets, for expansion, diversification and modernisation etc. Commercial banks are security oriented. Development banks are project oriented. A project which has the potential of promoting an industrial structure conforming to national priorities, such as location in backward area, encouragement to new entrepreneurs, promotion of balanced regional development are favourably considered by development banks despite their long gestation periods.

In India, the term public financial institution includes a large number of institutions. A few are listed below:

- Industrial Credit and Investment Corporation of India Limited (ICICI);
- Industrial Finance Corporation of India (Now IFCI Ltd.);

- Industrial Development Bank of India (IDBI);
- Unit Trust of India (UTI);
- Life Insurance Corporation of India (LIC);
- National Housing Bank (NHB);
- State Financial Corporations (SFCs).

Thus, financial institutions includes — development banks, public sector insurance companies, public sector mutual funds, specialised financial institutions promoted to develop certain high priority sectors, and state level development banks.

The types of financial assistance provided by public financial institutions are as follows:

(i) They provide medium and long term finance to industrial enterprises at a reasonable rate of interest. Thus, companies may obtain direct loan from the financial institutions for expansion or modernisation of existing manufacturing units or for starting a new unit.

(ii) Often financial institutions subscribe to the debenture issue of companies.

(iii) Some of the institutions also subscribe to the shares issued by companies.

(iv) Financial institutions underwrite the public issue of shares and debentures by companies.

(v) They guarantee loans, which may be raised by industrial enterprises from other banks and financial institutions.

(vi) Loans in foreign currency may also be granted for the import of machinery.

(vii) The institutions stand guarantee for purchase of capital goods from foreign countries.

8.7.2 Non-Banking Financial Companies (NBFCs)

In recent times, non-banking financial companies (NBFCs) have emerged as a significant sector of institutional finance. NBFCs are financial institutions which have diversified their activities to cater to specific financial services to include areas not covered by other institutions. NBFCs when compared to commercial and cooperative banks are a heterogeneous group of finance companies.

Thus, NBFCs engage in a variety of fund based as well as non-fund based activities. Fund based activities are those which involve finance. Non-fund based activities are fee based activities i.e., advisory services. Depending on their nature and type of service provided, fund based NBFCs are categorised as one of the following:

(i) Leasing company;
(ii) Hire purchase company;
(iii) Housing finance company;
(iv) Venture capital fund.

The chief non-fund based activities include:

(i) Issue management;
(ii) Corporate counselling;
(iii) Forex advisory services;
(iv) Credit rating;
(v) Portfolio management.

NBFCs are a significant part of the financial system. They broaden the range of financial services to include areas not covered by other institutions. Some prominent NBFCs are Kotak Mahindra Finance, SBI Capital Markets and Infrastructure Leasing and Finance Corporation.

8.7.3 Investment Trusts (Unit Trusts and Mutual Funds)

Investment trusts are investment institutions, which pool the savings of investors and invest them in a well diversified portfolio. A portfolio refers to the set or collection of equity shares/ debentures and other securities held by the investor. Investment trusts with their collective resources can invest in several securities at the same time. Investment companies invest in a combination of fixed income and variable income securities i.e., both debt and equity. Moreover, equity shares are selected across industries and sectors. If one sector or share is doing badly, there are probably others faring well.

The features of investment trusts are:

(i) Risk reduction: There are some investments in fixed income securities which provides a guaranteed inflow of cash. Thus, investment trust helps to reduce risk.

(ii) Professional management: Investment trusts pool the funds of a large number of investors. Since the corpus of the fund is likely to be quite large, professional experts can be hired for managing investment in securities. This is likely to produce better results than what the individual investor could have obtained through direct purchase of securities, with his limited capital and knowledge.

(iii) Diversification: A key feature of investment trusts is diversification. They enable the investors, through a single commitment, to diversify investment over a large number of securities, thereby reducing the risks of bad investments and poor dividends. It may be noted that some financial experts are of the opinion that the term *investment trusts* is not suitable, and such institutions should be called investment companies.

(iv) Overcomes weakness of equity: Investment trusts have emerged primarily because of the inherent weakness and risk associated with equity investment. The disadvantage of equity is that the fortune of the investor gets linked to the performance of the company she/he had selected for investment. Thus, a wrong decision can prove to be very costly for a small investor.

Investment Trusts may be classified into two categories:

(i) Open-ended;

(ii) Close-ended.

Open-ended schemes can sell their units continuously in order to raise additional capital. They can also redeem their units (repurchase their units) for enabling investors to liquidate their investment. This redemption feature of units ensures high degree of liquidity. This advantage induces a large number of small savers

The Mutual Evolution

The growth of the mutual fund industry in India can be divided into four Phases: Phase I (1964-1987); Phase II (1987-1992); Phase III (1992-1997); and Phase IV (Beyond-1997)

- **Phase I** commenced with the establishment of UTI in 1964 and the launch of Unit Scheme 1964 (US-64). During this phase, UTI was the only institution offering mutual fund products and it experienced a consistent growth. US-64 became increasingly popular as an alternative to bank deposits. Mastershare, the equity growth fund launched in 1986 was the first product in India to provide a dedicated vehicle for the entry of small investors into the equity market. It proved to be a grand marketing success. The year 1986, also saw the launch of India Fund, the first Indian off-shore fund for overseas investor, which was listed on the London Stock Exchange.
- **Phase II** witnessed the advent of competition in the mutual fund industry with the launch of mutual funds by subsidiaries of the nationalised banks and of the two insurance corporations viz., Life Insurance Corporation of India and the General Insurance Corporation of India. In 1988, UTI also floated another offshore fund viz., The India Growth Fund which was listed on the New York Stock Exchange. The buoyant equity markets in 1991-92 and tax benefits under Equity-linked Savings Schemes enhanced the attractiveness of equity funds.
- **Phase III** marked the entry or private sector funds including foreign sponsors as also the prescription by the Securities and Exchange Board of India on mutual fund regulations in 1993. UTI's Mastergain, launched in May 1992, was a phenomenal success with subscription of Rs 4700 crores from 63 lakh applicants. During 1995 and 1996, as capital market conditions were not conducive, the Net Asset Value (NAV) of the equity funds showed declines and closed funds traded at a discount to the NAV and, for the first time investors saw an erosion in the value of the their investments.
- **Phase IV** saw in the initial years significant growth in the mutual fund industry aided by a more positive sentiment in the capital market, significant tax benefits and improvement in the quality of investor service. Invisible funds, at market value of the industry rose by June 2000. This trend has however, sharply reversed in 2000-2001 and investible funds at market value have declined and there have been significant declines in the NAVs of funds.

Source : Fortune India

to make investment in units. Open-ended investment trusts are also referred to as unit trusts.

In India, the Unit Trust of India's US-64 is the most notable example of open investment trusts.

Close-ended investment trusts are open to the public for a specified duration only. Thereafter, subscription to these is closed. Thus, the corpus or fund collection of the trust is limited to the amount collected within the stipulated time. The popular term in India for a close-ended investment trust is mutual fund.

It is interesting to note that though the concept of Mutual Funds was implied in the Unit Schemes introduced by the Unit Trust of India since its inception in 1964, the term Mutual Fund was not in popular usage. It has become popular only recently.

Merits

The advantages of investment trusts i.e., unit trusts and mutual funds are:

(i) Diversification of risk: As funds are invested in a large number of securities, individual investor's risk is

The UTI Fiasco

The Unit Trust of India: This is the largest mutual fund in the country, let down investors once again in less than three years. The July 2 announcement of a ban on the sale and repurchase of UTI's US-64 scheme, the largest in the country with a unit capital of Rs 12786 crore (as on 30 June 2001) made investors nervous, dampened the capital market sentiment, affected UTI's image and shattered the myth that all's well in the mutual fund sector. On top of this, the dividend for US-64 was cut to 10 per cent from last year's 13.75 per cent. The ban has already led to the exit of the then UTI Chairman.

When every investor jumped on to the technology bandwagon in the year 2000, UTI also entered. But when all others exited tech stocks in the beginning of 2001, UTI refused to exit. It held on to its tech stocks which eventually lost 80-90 per cent of their valuation in 2001. The market was filled with rumours in the last one year about the UTI Ketan Parekh connection.

UTI's expensive purchase of infotech shares, aimed at bailing out Ketan Parekh, was the reason for today's debacle. After buying HFCL at very high prices, UTI lent HFCL Rs 50 crore in March when it was clear that the company was in trouble. It bought Zee Telefilm shares at over Rs 400 when most analysts had put a sell recommendation on it. It picked up Arvind Johri's Cyberspace Infosys at Rs 390 in a private placement (the shares are currently quoting below par), while the market price of the share was Rs 1100. It was known that the price had been rigged up by the rogue entrepreneur. Vinay Rai's ITIL shares were bought at Rs 2000 a piece, and these are now worth just a fraction of the purchase price.

Source : Fortune India

diversified, which is not possible in the case of direct purchase of shares by an investor.

(ii) Professional management: The Mutual Funds employ professional experts who manage the investment portfolio efficiently and profitably.

(iii) Liquidity: Open-ended schemes provide the facility of repurchase of the units from the investors at a price fixed by the trust. Liquidity is thus, provided to the investors.

(iv) Convenience: It is very convenient to buy and sell units through agents, no commission is to be paid.

Demerits

The disadvantages of investment trusts are:

(i) Breach of faith: Investors part with their money in the anticipation of obtaining expert financial management for their funds. If fund managers are not diligent or have malafide objectives, they may not make proper investment decisions. Thus, small investors are safe only if the management is trustworthy.

(ii) Stock market declines: If the conditions in the stock market are bad, that is equity prices in general are down, even skilfully managed portfolios lose value.

Types of Mutual Funds

Equity Funds: These are the funds, which invest their total investment in equity shares of various companies. Share market, as we all know, moves in an irregular fashion. Hence, value of these funds generally, fluctuates widely. These fund give excellent returns when stock markets are booming and their returns may turn negative when the markets plunge into a depression.

Growth Funds: When a sizeable portion (60-90 per cent) of the corpus of any fund is invested in equities, it is called a growth fund. In fact, there is only a very minor difference between equity funds and growth funds.

Income Funds: When a mutual fund invests a major portion of its corpus in fixed income instrument like corporate debt, state bonds, etc. it is described as an income fund. Here the returns are sure and generally, steady.

Balanced Funds: When any fund invests its corpus in both equities and debt instruments it is called a *balanced fund*. When equity funds tumble down, the fall in balanced funds is not that severe as only a part of the corpus is invested in equities. The nation of equities and debt instruments, whether 50:50 or 60:40 or 40:60 or any other proportion is decided by the fund manager.

These are the major types of mutual funds. Besides these, there are gilt funds (funds that invest in government securities) sectoral funds (funds that invest in one particular sector, say, IT, pharmaceuticals etc.) index funds, (funds that invest in scripts that form a part of any index.

Investment Trusts have been gaining increasing popularity in India. Till 1986, the UTI was the only investment trust/mutual fund in India. Presently, there are several mutual funds in both the public and private sectors.

8.7.4 Institutional Finance for Small Business

The Small Industries Development Bank of India (SIDBI) is the principal financial institution for the promotion, financing and development of small business in India. It is the chief financing agency for small scale industries credit, and the apex bank for small scale industries. SIDBI has been formed in keeping with the long standing demand of the small scale sector for a separate bank to cater exclusively to its financial needs. It was recognised that significant increase in the financial requirements of the small scale sector warranted an exclusive institution. SIDBI is the chief purveyor of term finance to the small scale sector in the country, including small scale industrial units, artisans, village and cottage industrial units in the tiny sector and small road transport operators. SIDBI is not only the chief financing agency of the small sector, it also coordinates with other state level financial institutions engaged in similar business.

The type of financial assistance provided by SIDBI are as follows:

(i) It provides term loans to SSI units for modernisation, technology upgradation and diversification.

(ii) It provides assistance for working capital requirements for SSI and tiny industries.

(iii) It provides assistance for rehabilitation of potentially viable sick units in the SSI sector.

(iv) It undertakes discounting of bills for small business.

(v) It provides services like factoring, leasing etc.

(vi) It provides venture capital to entrepreneurs, who have special innovative ideas and schemes, but are unlikely to obtain assistance through the conven-tional route of term financing.

(vii) SIDBI extends financial support to various institutions engaged in the promotion of small business, such as the State Financial Corporations (SFCs), State Industrial Development Corpora-tions (SIDCs) and State Industrial Investment Corporations (SIICs).

(viii) SIDBI has formulated the National Equity Fund (NEF) Scheme to provide equity type support to entrepreneurs for setting up new projects and for expansion, modernisation, tech-nology upgradation and diversi-fication by tiny/SSI units.

(ix) SIDBI has formulated Micro Credit Schemes to provide loan assistance to Self Help Groups such as:

- Societies registered under Societies Act;
- Trusts registered under Public Trust Act;

- Section 25 Companies;
- Institutions and Finance Companies focusing on banking with the poor;
- Specialised Cooperatives such as Mutually Aided Cooperative Societies etc.;
- Other Cooperatives.

(x) SIDBI has formulated a Credit Guarantee Fund Trust (CGFT) for Small Industries for guaranteeing the loans and advances up to Rs 10 lakh, without collaterals or third party guarantees, to small scale industrial units.

8.8 Special Financial Assistance Available to Industries in Rural, Backward and Hilly Areas

India's industrialisation in the post-independence era, has been geographically uneven and unequal. Some regions have been developing rapidly while others remain backward and under developed. The government has realised that private enterprises have done little to eliminate regional disparities. Therefore, it was necessary to deliberately channelise public investment in infrastructure development in favour of the less developed states to achieve balanced regional development. Balanced regional development is an important objective because of its economic and social implications. Its merits are the following:

(i) to provide employment opportunities more equitably;

(ii) to develop local skills and resources;

(iii) to provide for an equitable distribution of income and wealth;

(iv) to arrest the trend of mass migration from rural to urban areas, which bring about the problems of slums, congestion, pollution etc.

For the development of rural, backward and hilly areas, the government provides a number of incentives and financial assistance to units set up here. These include the following:

State Financial Corporations

State Financial Corporations (SFCs), operating at the State-level, form an integral part of the development financing system in the country. They function with the objective of financing and promoting small and medium enterprises for achieving balanced regional socio-economic growth, catalysing higher investment, generating greater employment opportunities and widening the ownership base of industry.

SFCs extend financial assistance to industrial units by way of term loans, direct subscription to equity/debentures, guarantees and discounting of bills of exchange. SFCs operate a number of schemes of refinance and equity type of assistance formulated by IDBI/SIDBI which include schemes for artisans, special target groups like SCs/STs, women,

(i) Availability of land at concessional rates to encourage setting up of industries in backward areas.

(ii) Location of large scale public sector projects in the backward areas with anticipated spread and linkage effects of development.

(iii) Establishment of industrial estates in backward areas to provide common facilities.

(iv) Development of infrastructure facilities, particularly banking, transport and communications and electricity in the backward areas.

(v) Tax holidays and tax rebates: Industrial units in backward regions are either exempted from paying income tax for a specified number of years, or granted special tax concessions.

(vi) Granting subsidies: From time to time the government announces subsidies to units set up in backward regions. A subsidy is a financial assistance provided to counter balances the effect of negative factors. To cite some examples:

  (a) Transport subsidy is provided by the government for carriage of raw materials and finished goods to and fro units in remote hilly/ backward regions.

  (b) Capital subsidy has been provided with a percentage of investment in fixed assets being met by the government for plants located in specified backward areas.

  (c) Infrastructure subsidy: The central government subsidises the state government on amount spent for a part of the development of infrastructure.

(vii) Consessional finance: Public financial institutions provide financial assistance at concessional rate to units in specified backward areas.

Special programmes for the development of backward and less developed regions have been initiated by the government, which are collectively referred to as the special areas development programmes. The important programmes currently in operation are the Hilly Area Development Programme, the North Eastern Council (comprising the seven states of Assam, Manipur, Meghalaya, Mizoram, Nagaland, Tripura and Arunachal Pradesh), the Desert Development Programme, and the Border Areas Development Plan.

Summary

No one can think of starting business activities or running a business without adequate funds at her/his disposal. Larger the size of a business firm larger is the amount required. While starting a business money is needed to procure

various types of assets. When the business is on, funds are required to meet the day-to-day expenses of production till money is realised on the sale of goods. Availability of finance is thus, essential for ongoing activities as well as for investment in durable assets.

Nature and significance of business finance: The importance of finance in business has increased with the growth in size of business firms. The necessity of finance also arises continuously for expansion, modernisation and introduction of new methods of production and distribution. Finance plays such a vital role in modern enterprises that it is often said to be the life blood of business.

Types of finance: Depending on the purpose to be served, the financial requirements of a business may be distinguished as long term finance funds required to be invested in the business for a long period, short term finance funds required to meet day-to-day operating expenses and for holding stocks of raw materials, etc. and medium term finance i.e., funds required for a period of 2-5 years for particular purposes.

Sources of finance: The primary responsibility of financing a business venture is that of the owners of the business. But loans and credits also meet the financial needs of business firms. Thus, for any business enterprise, there are two sources of finance, i.e. funds contributed by owners called owners' funds, and borrowed funds.

Owners' funds: It consists of the amounts contributed by the owners as well as their profits reinvested in the business. Hence, a large part of it is generally, used for acquiring long lived fixed assets. It is on the basis of this capital that owners have the right of control over the management of the business.

Borrowed funds or borrowed capital: It consists of all funds available in the form of loans or credit. Loans are raised by business firms for specified periods at fixed rates of interest. Thus, borrowed funds may serve the purpose of long term, medium term or short term finance. Borrowing involves fixed obligations to pay interest regularly and to repay the amount of loan when it is due.

Sources of company finance: The sources of long term finance for a company may include:

(i) Issue of preference shares and equity shares called ownership securities;
(ii) Issue of debentures (or creditorship securities) of different types;
(iii) Retained profits;
(iv) Public deposits;
(v) International sources GDRs , ADRs, and FDI;
(vi) Institutional Finance: Public financial Institutions, NBFCs, and Investment Trusts.

Equity shares: The holders of equity shares are the primary risk-bearers. But equity shares enable much higher returns to be earned by the shareholders during prosperity.

Preference shares: The amount of capital raised by the issue of preference shares is known as preference share capital. It carries a fixed rate of dividend to be paid if there are profits. The holders of preference shares have preferential claim over dividend payment and repayment of capital in the event of liquidation of the company. They have no right of control over management.

Debenture holders: They are the creditors of the company. A company may issue secured or unsecured debentures, covertible or non-covertible debentures. Debentures carry a fixed rate of interest and the interest paid can be charged as an expenses for tax purposes. Issue of debentures enables equity shareholders to earn a much higher rate of return on their investment than it would be otherwise possible.

Retained profit: This is an internal source of finance. It is a part of the ownership capital of the company. Successful companies make use of retained profits as much as possible for expansion of their business.

Public deposit: This is a source of medium term finance which can be raised by a company through advertisements inviting the general public to deposit their savings with the company. The depositors are like ordinary creditors because public deposits are not secured loans. It is only the large profitable companies which are in a position to attract public deposits. The rate of interest is higher than that allowed on bank deposits.

Financial institutions: At the national level they provide long and medium term loans at reasonable rates of interest. They subscribe to the debenture issues of companies, and underwrite the public issue of shares and debentures. They also guarantee loans and deferred payments. State level institutions are mainly concerned with the development of medium and small scale enterprises. They provide the same types of financial assistance as the national level institutions.

Non-Banking Financial Companies (NBFCs): These are financial institutions which have diversified their activities to cater to specific financial services to include areas not covered by other institution. They include — leasing companies, hire purchase companies, housing finance companies, and venture funding companies.

Investment trusts: These pool the saving of investors and invest them in a well diversified portfolio. A portfolio refers to the set or collection of equity shares/ debentures, and other securities held by the investor.

The Small Industries Development Bank of India (SIDBI): It is the chief financing agency for small scale industries credit. SIDBI has been formed in keeping with the demand of the small scale sector for a separate bank to cater exclusively to its financial needs.

Rural, backward and hilly areas: Special financial assistance to industries in rural, backward and hilly areas is provided by the government through a number of incentives like land at concessional rates, development of infrastructural facilities, tax holidays and rebates and granting subsidies.

EXERCISES

Short Answer Type Questions

1. Define the terms: medium term finance; convertible debentures; self-financing; cumulative preference shares.
2. Enumerate the short term and long term sources of company finance.
3. What is the difference between ownership capital and borrowed capital?
4. Why is equity share capital called risk capital?
5. Name three national level financial institutions and state their objectives.
6. What is the purpose served by short term finance?

Long Answer Type Questions

1. Explain the importance of finance in modern business.
2. Describe the advantages of borrowed capital as compared with those of ownership capital.
3. Why do some companies prefer to raise capital by the issue of preference shares? What are the limitations?
4. What are the characteristics of equity shares? What are the advantages of issuing equity shares to raise long term finance?
5. Explain the advantages of debenture issue as a source of long term finance. What are its drawbacks?
6. As a source of finance retained profit is better than other sources. Do you agree with this view? Give reasons for your answer. Can a company grow indefinitely by reinvesting surplus profits?

Project Work

1. Take a specific NBFC and find out the nature of projects, the funds and the risks associated with financing such projects.
2. Make a list of some mutual funds / investment trusts. Find out their objectives and the reasons for low returns in the recent past.
3. Prepare a scrapbook and collect articles on the UTI scam. How has the UTI affected millions of investors in India?

CHAPTER 9

Internal Trade

LEARNING OBJECTIVES

After studying this chapter, you should be able to :

- state the meaning of internal trade;
- describe the functions and services of wholesalers;
- explain the functions of retailers;
- classify the different types of retailers;
- explain the various forms of large scale retailers;
- discuss the features of direct marketing, telemarketing and internet marketing;
- cite examples of different retail stores.

9.1 Introduction

Trade, as we all know; is the oldest profession in the world. By trading we mean sale of goods and services for a profit. Traders in the earlier days used to visit places and sell their goods to customers on their route. Even now, in India, in towns, cities and remote villages we have different pedlars carrying vegetables, fruits, an assortment of toys and balloons and other merchandise. This is one kind of retail trade. We have come a long way from there. Consumers have higher expectations and want to select from a variety of products. Business, therefore, has to satisfy consumers by making goods available at the right place and right time. Trading has now become a complex process with people specialising in different activities to bring goods to the market.

Manufacturers have been expanding their operations and producing larger quantities and varieties of products. Their work has become more and more specialised leading to concentration on production and other related areas. It was necessary to depend upon other people for distributing their products. These people are known as middlemen or intermediaries as they act as major links between the producer and the consumer. Most manufacturers depend upon individuals and business concerns to perform the function of distribution and place their products in the market, mostly in retail stores.

Manufacturers may sell their products within the country or outside the country or both. Within the country certain specialised activities are performed by people and firms to bring goods to the ultimate consumers. This kind of distribution of goods in the country is called Internal Trade. Manufacturers produce goods for consumption outside the country also. These goods are designed according to international specifications and standards. This requires a different kind of specialised activity for the product to reach the ultimate consumer in another country. These trading activities form part of External Trade. Thus, there are two main types of trade: (i) Internal Trade; and (ii) External Trade. In this chapter, we shall discuss the nature and purpose of various forms of internal trade.

9.2 Internal Trade

Trade which takes place within a country is called internal trade. Goods can be freely bought and sold within the national boundaries of a country. Generally, payment has to be made in the legal tender of the country, or any other acceptable currency. Goods may be sold anywhere in the country as there is no restriction on the movement of goods. Some exceptions may be there where a particular state does not allow the entry of certain goods which are prohibited under law. Excise duties levied by the state have to be paid by the manufacturer before the goods leave the factory. This is then included as a part of the price. There are no

customs/import duties as these goods are part of domestic production and are meant for consumption within the country.

Internal trade can be classified into two categories viz., wholesale trade and retail trade. Wholesale trade is concerned with the buying and selling of goods for resale or business use. Retail trade is concerned with the buying and selling of goods and services to the ultimate consumers who use the product.

Most producers do not sell their goods directly to the final users. Between them stands a set of people or intermediaries performing a variety of functions. Goods pass through a number of hands before they reach the ultimate consumer. A chain is formed and goods are passed on to a wholesaler, who in turn sells them to the retailer or consumer. Wholesalers and retailers are important links in this chain. Thus, wholesale trade and retail trade form part of the process of internal trade.

9.3 Wholesale Trade

We as consumers are usually, exposed to shops and other retail outlets from where we purchase goods for consumption, but we have little knowledge about how products are actually moved from the point of production to the point of final sale and consumption and the way wholesale establishments function. Wholesalers form an important link between the producer and retailer and are essential for the distribution of goods. They perform a number of functions which include the sale and all activities related to the sale of goods to retailers and other business organisations. They purchase goods in bulk and divide it in smaller lots/quantities and sell them to retailers.

9.3.1 Functions of Wholesaler

Wholesalers perform several functions Thus, relieving the manufacturer and retailer of a number of tasks.

(i) Buying and assembling: The wholesaler selects and buys goods from different manufacturers. They collect them at one place and create combinations of goods for supplying to retailers as and when required.

(ii) Sub dividing or breaking the bulk: Wholesalers purchase goods in large quantities from manufacturers and divide them in convenient lots to be sold to retailers. Retailers usually, prefer to buy and stock smaller quantities. Wholesalers are able to avail of discounts on bulk purchases also.

(iii) Warehousing: Every manufacturer has to store goods till they are sold as there is always a gap between production and consumption cycles. Wholesalers provide warehousing facilities thereby removing time lags between production and quantities required by the market. At the same time since wholesalers hold inventories, it reduces the inventory costs and risks of producers and retailers.

Warehousing Facilities

Nowadays, wholesalers maintain well equipped warehouses. They use modern techniques for storage. This results in greater efficiency and saving in costs in terms of wastage and spoilage. Cold storage facilities are also used to provide certain seasonal foodstuffs all the year round. NAFED and HPMC store raw materials to meet their production requirements and ensure that their products are available in the market in all seasons. Foodgrains harvested periodically are stored to meet demands throughout the year. The Food Corporation of India (FCI) is responsible for procuring foodgrains from farmers and storing them in warehouses. The FCI here acts like a wholesaler and is the link between the farmer and retailers. It also provides large scale warehousing facilities in order to ensure that farmers get a reasonable price immediately after harvesting. At the same time the FCI ensures a continuous regular supply to consumers in the market.

(iv) Transportation: The wholesaler takes on the responsibility of physical movement of goods from the producer to the retailer or consumer. They are able to ensure quicker and better services in delivery to the retailer. When they provide storage facilities, they are in physical possession of the goods also. Therefore, it becomes easier for them to transport goods to the retailer.

(v) Financing: Wholesalers extend credit facilities to retailers and at the same time finance producers by placing orders well in advance and paying bills in time. Retailers are usually reluctant to pay cash for goods as they have to sell them further to the final consumer. They prefer to purchase on credit as goods may have to be returned due to obsolescence or changes in fashion or style. Wholesalers fill in this gap by providing short term credit.

(vi) Selling and promoting: Wholesalers employ a sales force to reach many small business customers and retailers. They perform the function of promoting the company's product and persuading retailers to display and sell the products. Retailers find it convenient and also feel confident in dealing with wholesalers than distant manufacturers.

(vii) Risk bearing: The risk of holding the goods is borne by the wholesalers. They normally acquire title to the goods, i.e., there is a legal transfer of ownership of goods to the wholesaler. Therefore, he bears the risk of theft, damage, spoilage and obsolescence of goods.

(viii) Market information: Wholesalers keep themselves informed of the changes in the market. They are in a position to feel the pulse of the market. They act as a two way channel between producers and retailers. They supply information regarding competitors activities, new products and price changes. Manufacturers can accordingly change their production patterns to suit the market.

(ix) Grading and packaging: Wholesalers usually, perform the function of sorting the products according to quality and certain grades. This procedure is usually followed in the grain market like rice, pulses, wheat etc. and other agricultural produce. They are packed in attractive packages of convenient sizes and made available for sale in the market. The labels on the packages are usually of the wholesaler and not the producer.

9.3.2 Services of Wholesalers

Wholesalers provide services of value to manufacturers and retailers by filling the gaps between the seller (producers) and the buyer (retailer/final consumer). The gaps may be because production and demand schedules do not match or products are not available at a particular place. Thus, wholesalers create both time and place utility.

Services to Manufacturers

(i) Sales persons to manufacturers: Wholesalers provide a sales force to reach small retailers and other businesses where manufacturers do not maintain a sales force of their own to contact retailers or business. Some manufacturers do not find it cost effective. The wholesalers sales persons perform the task of contacting, persuading and finally selling products of various manufacturers to retailers.

(ii) Economies of scale: Producers are able to avail of the economies of scale as the wholesalers are in a position to place bulk orders. Wholesalers collect small orders from a number of retailers and place the orders in advance with the manufacturers/producer of goods. They pool the orders of many retailers and create a market for the producer. Producers are able to undertake production on a large scale, install advanced technology and minimise production costs.

(iii) Market information: Wholesalers being in constant touch with the retailers are able to get feed back from customers through retailers. They collect information about market demand, competitors products and changes in fashion or style. This is of great help to manufacturers as they can organise their production activities accordingly.

(iv) Storage: Wholesalers provide storage facilities for finished goods. They take full responsibility for storing the products and bear the risk of theft and damage due to spoilage and obsolescence. This reduces the burden of the manufacturer of providing for storage facilities of finished goods.

(v) Financial support: Wholesalers place orders and pay for the products before the retailer/customer has purchased them. They may provide financial assistance to manufacturers in the form of advance for bulk orders.

(vi) Concentration on production: Wholesalers assist manufacturers by handling all their distribution

activities. Producers are, therefore, able to channelise all their energies in production. Since they are specialised in the area, they are able to keep themselves informed about the latest technology.

(vii) Physical distribution: Wholesalers provide transportation facilities for the physical movement of goods from the producer to the retailer. They are able to make quick and frequent deliveries to retailers since they are situated in the market. They have a wide network of distributors all over a particular area.

Services to Retailers

(i) Availability of goods: Wholesalers provide a valuable service to retailers by making goods available to them in small lots as and when required. They buy a variety of products from manufacturers and supply to retailers according to customer needs. It may not be possible for retailers to approach different manufacturers directly. Wholesalers perform the task of sorting out and assembling goods from several manufacturers.

(ii) Financing: Wholesalers sell goods on credit to retailers thereby reducing their working capital requirements. Retailers make payment only after goods are sold to the final consumers. They are, therefore, able to manage with a relatively smaller amount of working capital.

(iii) Risk taking: The wholesaler by holding large quantities of goods assumes the risk of spoilage or damage of goods and price and demand fluctuations. Therefore, the retailer is not required to hold large stocks thereby reducing the risks associated with storage of goods and price fluctuations.

(iv) Management assistance: Wholesalers assist small retailers by advising them on matters like quality, durability, price and timings of purchase. They are well informed about different products in the market. Wholesalers may also advise on the décor of the retail outlet or allocation of shelf space to a particular product. Sometimes, when the wholesaler wishes to introduce a new product in the market there may be an agreement with the retailer about the display or demonstration of a particular product. New soft drinks, coffee, chocolates, stain removing solutions are introduced in this manner by offering free drinks or trials on the spot.

(v) Transportation: Wholesalers are in a position to make frequent deliveries to retailers and may at times supply to customers. They arrange for transportation facilities and deliver goods at the doorstep of the retailer.

9.4 Retail Trade

The retailer is the last link in the distribution channel. Any organisation or individual selling to the final consumer or end user is doing retailing. Retail trading may be organised by a manufacturer, wholesaler or retailer. Goods may be

sold in person, by telephone, mail or internet or vending machine or in a store, on the street or in the consumers' home. As long as the consumer is using the product for her/his personal, non-business use, it is a retail sale. Retailing or retail trade consists of the sale, and all activities directly related to the sale, of goods and services to ultimate consumers for personal, non-business use. Retailing need not necessarily be carried on in a shop or store or fixed structure. It may be by people selling door to door, or even selling at traffic lights by hawkers and pedlars. We are all aware of these small time retailers whom we see in our everyday lives. But now, times have changed. Did you know that you could order products on your computer also? By browsing through the internet and going to a particular site, you can just feed in your order and there it is. These are some of the new trends in retailing which we shall study in detail.

Functions of Retailers

Retailers perform the important task of reaching out to the consumer and providing them with a variety of services. These marketing activities are related to the exchange function:

(i) Assortment of products: Retailers keep an assortment of products to offer to consumers. A wide range of products, different brands of the same product and all sizes are usually stocked by the retailer. These products are procured directly from the manufacturer or wholesaler.

(ii) Provide information: The retailer informs consumers that certain products are available. This information is conveyed by distributing leaflets, handbills, display of products on show window, local cable advertising and on sign boards.

(iii) Convenient location: The retailer ensures the location of the retail store is appropriate, safe and convenient. Proximity to customers also has to be considered. If these basic features are overlooked there are chances of customers not visiting the store. Parking facilities and accessibility are important considerations for customers.

(iv) Pricing: The retailer ensures prices are fixed appropriately and fairly. The prices of standardised products are marked with MRP i.e., maximum retail price. The retailer's profit margin is also included in the MRP as the wholesale price is much lower than printed. There are some products like textiles and readymade garments. The pricing of these products are fixed by the retailer after adding a profit margin to the manufacturer's or wholesaler's price to recover the cost of retailing.

(v) Display arrangement: The retailer must provide shelf space to stock a variety of products. Some wholesalers and manufacturers want to display their products in a particular manner. The products must be unpacked, labelled and displayed properly.

(vi) Credit arrangements: Retailers, at times may extend credit

facilities to customers. They may also arrange with a finance company or a bank to finance purchase of products on installment basis, as in the case of televisions, washing machines, and other consumer durables.

(vii) Sales assistance: In big cities and towns the retailer engages, trains and supervises sales persons to assist customers in buying. Some retailers are now shifting over to self help services and hiring fewer employees. But in small towns and villages, the local retail stores selling general or specialised products are still run by the proprietor. Sales assistance is required depending on the size of the store and the specialised nature of goods it sells.

(viii) Demonstration and after sales service: The retailer demonstrates the working of the product and undertakes to provide after sales service. A full demonstration and trial run of the product is given as in the case of automobiles.

9.5 Classification of Retailers

Retailers are classified according to their size, product mix, prices, services, ownership and site.

(i) Size: Retailers range in size

Challenges Facing Indian Retail Industry

Indian retailing is going through a process of accelerated evolution. Any retail organisation has three dimensions — the resource, the distribution and the consumer. The political, legal, economic, social and technological aspects are also undergoing major changes and they have had an impact on retailing. Indian retailers face profound challenges when it comes to consumers. Consumers needs and aspirations are changing at a rapid pace and so are their shopping and buying behaviours. What we are seeing is the emergence of a hybrid consumer. For example, a person who does not blink while buying a pair of branded sports shoes for Rs 2500 will haggle with the shopkeeper to reduce the price of socks which are being sold for Rs 50 only.

This shows that the consumer wants value from whatever she/he is buying and at the same time gives a lot of value for branded products. This trend in consumer behaviour challenges the retail practices and structures. Retailers will have to provide more and better for less. The seven rights of retailing: giving the right goods at the right time, place and price, of the right quality and quantity and the right wear have become for more important now-a-days.

Besides this, there is a substantial mismatch between customers expectations and the ability of the supply chain to meet these expectations. Efficiency and effectiveness in retail operations are key issues. Issues relating to supply chain management, store operations and understanding customers are some of the key challenges facing the Indian retail industry.

Source : The Economic Times

from small, independent, owner-operated shops like the local general store, dry cleaner, chemist shop to national giant category shops. Consumers visit particular retailers for a variety of reasons which may not really be rational or objective. Some consumers visit large retail houses as they like browsing around and looking at the attractive displays and they find it more entertaining to be in a bigger and brighter place.

(ii) Product mix: The product mix refers to the variety and range of products collected and offered by the retailer for sale. The type of products offered differ from store to store. For example, speciality shops specialise in a particular line of products like dress material or clothing or electronic goods. Whereas a large departmental store may stock a variety of products in different departments. Retailers may be classified according to the type of products that they deal in.

(iii) Pricing: This refers to fixing the prices of products. Some products are priced above market rates or at or below market rates in particular retail outlets. This is usually done for non-standardised products. Retail outlets in certain areas may have expensive items which are priced higher as they are catering to a different clientele. Thus, pricing of products depends upon the retailers location. Lower prices are expected from small general stores which stock a limited variety of goods. Then there are certain stores which may hold frequent discount sales and give heavy discounts to clear stocks. Sometimes, retailers invest huge amounts in building infrastructural facilities. Accordingly, products are priced higher to cover overhead costs.

(iv) Service level: There are certain retailers who offer different services like credit facilities, gift wrapping, alterations, delivery and so on. Some customers may visit a shop for precisely these reasons. Other stores may be self-service where there is no assistance available. Certain shops give expert advice by professional sales people on the working of products like electronic items.

(v) Form of ownership: Small retailers outlets like speciality shops, general stores, etc., are independently owned. They are mainly family run stores and do not compete with the bigger giants. The large departmental stores and multiple shops are usually run by companies as they require huge investment. Management is centralised and they are publicly owned. Another common ownership retailing is the cooperative type where group of consumers form an organisation to run a cooperative store. A cooperative can be run by a group of sellers like weavers cooperative to pool in their resources and marketing efforts.

9.6 Types of Retail Trade

Retail organisations may be classified into two categories:

(i) Itinerant retailers and fixed shop retailers;

(ii) Large scale retailers.

In India, we have developed unique styles of trading depending on our needs. Itinerant traders are quite common in our country. They generally, include vendors like hawkers, pavement traders, etc. These retailers keep moving from place to place. In villages we have only one shop dealing with a variety of goods ranging from food items to stationery to cloth and other special items. On the one hand, in big cities and towns we have itinerant traders and on the other departmental stores organised on a large scale. We have traders with low priced consumer goods and sophisticated shops with high priced, quality goods comparable to international standards. It might just happen that outside a large scale departmental store, you have these street traders displaying their wares and selling their goods on the pavement. This contrast still exists in countries. This will be there so long as there are economic and social disparities.

9.6.1 Itinerant Retailers

Itinerant traders are found in all cities, towns as well as villages. The most common types of such traders are the following:

(i) Hawkers and pedlars: Hawkers and pedlars are traders, who move around from place to place, selling their goods. They usually, carry their goods in a bag or on a cart or a cycle or on animals. They move in residential areas, buses, trains, near bus-stands and railway stations. They sell a variety of goods like toys, bangles, fruits and vegetables in residential areas, sweets, peanuts, toys, fruits in buses and trains. They deal in ordinary, non-standard articles. People find it convenient to buy from them at their doorsteps. Even now, inspite of super markets and other cooperative stores, they are very popular. Their only disadvantage is that they do not carry many varieties of the same product. Thus, customers have a limited choice.

At busy, traffic crossings these traders are very daring and dart in between fast moving traffic. Inspite of these limitations they are able to sell the wares to passengers in buses and people travelling in cars. Their assortment of products seems to be increasing and they deal in almost anything from magazines, news-papers, and latest designs of car dusters, towels/tissues to balloons and small plastic toys. There are no fixed prices and prices are fixed according to agreement/bargaining between the customer and pedlar.

(ii) Periodic market traders: These traders sell their articles on fixed days in different market places. A special feature of theirs is that they come with a periodicity and their weekly market day is fixed. In small towns and villages these are very common, where all the villagers can come to a central location and purchase goods according to their needs. These traders come from far and wide and set up temporary structures, if required, and sell their

products. These goods range from food-grains fruits and vegetables to utensils and plastic products. Now-a-days, in cities also this is becoming very common in every locality. You must have heard of Saturday Bazar, or Mangal Bazar which is prevalent in North India. The goods available are low priced and not of very high quality. These traders also set up shops on the occasion of festivals, such as Diwali Melas, Christmas Bazaars and sell commodities which are specially, demanded on these occasions. Here, they may sell a larger variety of goods which include ladies bags, shoes, stationery, and some sophisticated items also.

(iii) Street traders: These retailers generally, display their articles on busy street corners, bus stands, pavements, or in and around offices or commercial areas. They sell articles like books, diaries, pens, newspapers, magazines etc. Sometimes they may have readymade garments, handkerchiefs, towels and other things of daily use. These products are generally, low priced and of common use. People find it convenient to pick up items on their way back from work.

9.6.2 Fixed Shop Retailers

Fixed shop retailers as the name suggests are those retailers who sell their goods from fixed places or shops usually, situated in market places or residential localities. They usually, run their business operations on a small scale and deal in a limited line of goods. These retail shops are of six types:

(i) General stores;
(ii) Single line stores;
(iii) Speciality shops;
(iv) Street shops;
(v) Second hand goods shops;
(vi) Seconds shops.

(i) General Stores: These stores deal in items of daily use, like groceries, confectionery, stationery, soft drinks, etc. They have a large variety in each line of goods. Popular brands of products are also available. Now all imported foodstuffs are freely available in these stores. They provide free home delivery, credit facilities and other services to regular customers. Depending on the locality and clientele they serve these stores, serve the purpose of providing items of daily use. They form a personal relationship with the customers and keep them quite happy and satisfied for their daily needs, except when, if they require some rare type of a particular product, the general store may not be stocking. Otherwise, by and large, these stores are well stocked.

(ii) Single line stores: These stores deal in a general category product line. The product line may consist of readymade garments, textiles, medicines, shoes, stationery or books. They will have different designs, styles, sizes and quality of the same product line. For instance, a store dealing in shoes will have all types and different designs of shoes for ladies, gents and children. They are situated in market places. They cater to the requirements of a particular category

of customers and accordingly stock goods of that product line. They have a wide range of goods in the product line and provide customer service which varies from store to store.

(iii) Speciality stores: These stores deal in a particular product line only. The products include certain special products or special branded products. They provide a wider choice in that particular product line. For example, a store dealing in bakery products will have a variety of items in pastries, pizzas or burgers. Or a sweet shop will be specialising only in Bengali sweets and have different kinds of such sweets. A store may be selling only jeans of a particular brand or jeans of one or two special brands or a store may be specialising in sports apparel of different brands or only one brand. Customers these days are aware of different brands in the market and would like to compare them in one shop. Therefore, customers find it convenient to enter a speciality store. In times to come, speciality stores will be able to take advantage of product specialisation and targeting a particular segment of the market.

(iv) Street shops: These shops can be defined in terms of their location. Street shops are those shops which are situated at street crossings or on main roads or on corners of colonies. They may be set up in corridors of markets also. They are also known as street stalls and are located just about anywhere. These retailers display their goods on a table, stand or by fixing a shelf on the wall. Low priced articles are usually, sold in these stalls, such as pens, hosiery goods, cosmetics, magazines and story books. Recently, there is a trend towards stocking finer quality goods and slightly expensive items. They have been selling imported cosmetics, garments and even costume jewellery. But, their goods and prices depend on their location and clientele. Prices are fixed by mutual agreement/ bargaining between the owner of the stall and customer.

They pay a small amount as rent for floor space either to the shop owner or to the market association. But, these are not permanent and they are always under the threat of closure by authorities like corporation officials and police.

(v) Secondhand goods shop: These shops sell secondhand goods of different kinds like furniture, books, clothes and other household articles. Since they are used goods, they are not priced heavily. Their customers consist of those, who cannot afford to buy new items. But, at the same time they stock rare objects of historical value and antique items. Some customers, who value such items may like to pay very heavy prices to procure them.

Thus, their clientele consists of people from all income groups. Those who cannot afford and those, who would pay exorbitant prices just to own an antique. These retailers fix their prices accordingly.

(vi) Seconds shop: These shops sell goods which are not produced according to the required specifications. These goods always have some

defect in them and hence, they are termed as seconds goods and the shops selling them are called seconds shop. In some of the goods the defect is not quite visible. These are sold at heavily discounted prices. The seconds shops are situated in market places. Many manufacturers have their own retail outlet to sell these goods. Sometimes, these shops may be set up temporarily for the sale of such goods or premises may be taken on hire for the purpose.

9.6.3 Large Scale Retailers

In large scale retailing, it is the volume and variety of goods stocked that is large. Large scale retailers operate on a large scale. They are characterised by huge investments, large size of showrooms and a large number of customers. Thus, large scale retailing may be defined as retail trade involving operations on a large scale and sale of goods in small quantities. There are different forms in which large scale retailing may be organised. The most common forms are:

1. Departmental Store;
2. Multiple Shops or Chain Store;
3. Mail Order Retailing;
4. Consumer Cooperative Store;
5. Super Markets; and
6. Franchise.

Organised Retailing

A new organised approach for consumer goods retailing may be good for the customer, but its business benefits are imponderable. Organised retailing is either big business or an industry that is not going to take off in a hurry. Big business houses that have entered this segment are Tatas, S.Kumars, Piramal, and Rahejas. There are stores specialising in food and grocery items (Food World, Nilgiris, Food Plus) and have electronics (Vivek's) as also Shoppers Stop in Delhi and Crossroads in Mumbai. There is also speculation that international chains like Boots, Marks & Spencer, and Home Décor too are looking at the Indian Market. The concept of organised retailing, which actually started with Shoppers Stop when it laid emphasis on running the business in an organised and scientific manner, has seen sudden and quick growth in the last four years exposing shoppers in big cities to a comfortable shopping experience. Though, the concept of multibrand stores (like Akbarallys in Mumbai and Snowhite in Delhi) or even chain outlets selling a single brand (like Raymond or Nalli Sarees) has been in India for decades, organised retailing as a concept has changed the way in which business is done.

Industry watchers expect the growth in the organised retail sector to be 5-10 per cent of total growth in the retail industry in the 10 big cities over the next 10 years. It is much higher than the other retail activity – Home Shopping. According to studies less than 1 per cent of those who have access to computers and internet shopped on the Web.

Source : Business India

1. Departmental Store

A departmental store is a retail organisation which offers a variety of products in separate departments under one roof. It is a large establishment having a number of departments, each confined to a particular line of goods, like toiletries, medicines, furniture, books and stationery, electronic goods, clothing and dress material and so on. Each of the departments is like a separate shop. With centralised purchasing, selling, accounting and administrative matters of the departments are managed by the respective departmental managers. However, all the departments are coordinated and controlled by the General Manager as head of the central organisation.

The main features of departmental stores are as follows :

- A wide range of products from low priced items to very expensive goods are dealt with in separate departments under one roof.
- The store is departmentally organised. Goods offered for sale are classified and each department specialises in a particular line of goods.
- Purchases are made centrally. Sometimes, the departmental managers are entrusted with this task.
- Taken as a whole, the store represents a complete shopping centre which caters to the needs of all categories of consumers, men and women, young and old.
- They are located in central places so that people may conveniently reach there from different parts of the city.
- Departmental stores provide a number of services and facilities to the customers like rest rooms, telephone booths, restaurant, etc.

Advantages

Some of the major advantages of retailing through departmental stores are as follows:

(i) Central location: As these stores are located at central places, they attract large number of customers during the day.

(ii) Shopping facility: These stores offer a large variety of goods under one roof. The shopping facility enables customers to save time and effort of making purchases at different places.

(iii) Benefits of large scale: As the departmental stores are organised on a large scale all the benefits of large scale operation, particularly in respect of purchase of goods, are available to them.

(iv) Expert services: Because of their relatively sound financial position, the departmental stores are in a better position to avail of the services of experts, in buying quality products at reasonable prices, in promoting sales, and the like.

(v) Financial resources: Having large financial resources, departmental stores are able to spend considerable amounts on advertising and sales promotion which go a long way to increase their sales.

(vi) Services to customers: Departmental stores provide various services to the customers which may include home delivery of goods, telephone facilities, credit and provision of rest room, restaurant, hair dressing saloon.

Limitations

Although retail selling through departmental stores has several advantages, it has also certain limitations:

(i) Lack of personal attention: Because of the large scale of operation, it is very difficult to provide adequate personal attention to the customers in a departmental store.

(ii) High operating cost: The expenses of departmental stores on advertising, window display, interior decoration and provision of facilities, etc. make their operating cost relatively higher than small scale retail shops. Hence, the sale price of the goods is somewhat higher.

(iii) Huge capital: A departmental store requires huge capital to be invested. The cost of establishing it and the recurring costs of operation are too high.

(iv) Not located everywhere: Many people do not like to travel a long distance to reach centrally located departmental stores, particularly for buying articles of daily use.

Inspite of some of these limitations the departmental stores are very popular in some of the western countries. However, this type of retail organisations have not grown in our country except in big cities like Mumbai, Delhi, Chennai, and Kolkata.

Retail Detail

Sahara is trying to position itself as a destination shopping mall. It is building five different levels for shopping and entertainment with two levels for shopping and entertainment and two levels specifically for parking. Anything from new age products, to children's clothes, fashion books, electronics and IT products, furnishings and white goods and food courts will be available here. The top levels house a health club, gym, pool and banqueting facilities.

Retail Revolution

New projects have been initiated in Gurgaon by developers like DLF, Unitech, MGF and Sahara. The DLF group has been one of the most aggressive in creating international quality retail space in Gurgaon. The DLF mega Mall is a giant project. The two floors of centrally air-conditioned space will have piped music, enticing displays of the best global brands, specially designed rest zones and an array of entertainment options. It will be a complete family entertainment store.

Source : The Economic Times

2. Multiple Shops/Chain Stores

Multiple Shops refer to retail shops owned and controlled by a single organisation and located in different parts of a city or throughout the country. These shops are also known as chain stores. Chain stores deal in a limited variety of products. The same line of products are available in every shop which is run by a manager. The goods are centrally purchased or produced. Prices are also fixed by the Central Office. Goods are supplied to each store from time to time according to the requirements. There is uniformity in the outward setting and interior display of products of all the stores. Chain stores may be set up by *manufacturing or trading companies*. In India, manufacturing companies like Bata have established their own chain stores.

Advantages

Advantages of multiple shops/chain stores are mentioned below:

(i) Economies of scale: Because of large scale organisation of retailing with manufacturing or procurement there is considerable economy in the cost of operation of multiple shops.

(ii) Standardised products: These shops deal only in standardised products, hence, the buyers are reasonably assured about the quality of the products.

(iii) Spreading of risk: Since such shops are situated in different localities of a city the business risk is minimised. For example, if a particular item is not in demand at one store, it may be sent to another store or, if a store is not doing well, it may be shifted or closed altogether.

(iv) Attractive location: Usually, most of the chain stores are situated at residential locations, or in busy shopping centres. This enables the stores to serve large numbers of customers during best part of the day.

(v) No bad debts: As a matter of policy goods are sold on cash only; hence, there is no risk of any bad debt in such shops.

Chain Stores in Music — A New Concept

Music World Entertainment Ltd. opened its first Music World outlet in 1997 in Chennai and 14 others all over the country. There are outlets in Shoppers Stop, Spencer Plaza, Qwikys, BPCL for enticing shoppers and impulse buying. These stores reflect every nuance of music for the customer of every age group. Indipop, religious classical, international chartbusters, film music, concert Music World claim to have them all. They have tied up with other stores to bring in international design and technology. They have recently launched a *Masticard* which entitles a customer to buy this card for Rs 50 with any purchase of Rs 300. The flashcard aggregates all kinds of discounts from other retailers like Shoppers Stop, Louis Phillippe and many top brands.

Source : Business India

(vi) Easy identification: As multiple shops have uniform external decor and internal display, they are easily identifiable by the customers and others.

(vii) Centralised advertising: Most of the advertising for all the branches is done by the central office which brings economies of scale in this regard also.

Disadvantages

Disadvantages are the following:

(i) Individual tastes not satisfied: As these shops deal in standard products, it is not possible to satisfy different types of customers in situations where individual tastes and design of the products play an important role.

(ii) Limited range of goods: Multiple shops deal in a limited range of goods, and customers do not have wide choice.

(iii) Inflexibility of operation : Each shop is centrally controlled, there are uniform policies adopted for all with respect to price, etc. This prevents the shop manages from adjusting to local conditions and opportunities.

(iv) Absence of initiative: The branch manager of a multiple shop is just like a head salesman. She/he has no initiative, no voice in making purchases and fixing prices of the goods. Thus, there is lack of initiative on her/his part.

(v) Divided attention: Manufacturers undertaking retail distribution through multiple shops have their attention divided between production and distribution. They may not be in a position to attend to both these functions with equal efficiency.

Departmental Store Vs Chain Stores

Both departmental stores and chain stores are forms of large scale retail organisation. But there are certain difference between the two, which are explained below:

Organised Retailing — Departmental Stores and Chain Stores

Local retailers are slowly waking up to opportunities in markets other then their local base. Nallis, Vivek's and Haldiram have their retail outlets in other cities as well. Nallis is present in Toronto, Singapore as well as Mumbai, Delhi and Chennai. Local retailers are also tying up with national department store chains like Ebony and Lifestyle to sell ethnic wear within the store. The national chain stores are open to any kind of merchandise that the customer demands. It is beneficial for both of them. The local brand gets instant recognition with so many people visiting the store. Retailing in giant stores is very good for brand building. The local retailer also benefits from the infrastructure provided. The cost of real estate is also very high and expansion is difficult. National chains also benefit from this arrangement in certain categories where they have little expertise.

Source : The Economic Times

Departmental Stores	Chain Stores
1. Objects It provides goods to satisfy all requirements of the customers at one place.	They deal in a limited range of merchandise, mostly standard consumer products.
2. Volume of Investment It requires huge investment as large stocks of varieties of products are maintained and a number of services are provided to the customers.	May require relatively small capital investment in stocks as goods needed at one place may be replenished from some other nearby place. Also, they do not provide other services to the customers.
3. Credit/Cash Basis Usually, departmental stores offer credit facilities to their regular customers.	Chain stores sell goods only on cash basis and do not grant credit to customers.
4. Location Departmental stores are located at central places so as to be accessible to people from different parts of the city.	These are located near residential areas or in busy markets.
5. Prices As the emphasis is more on providing quality goods and services, the prices charged by departmental stores are relatively higher.	The prices charged at multiple shops are relatively low as there is selling of standard products in such shops.
6. Centralisation of Activities There is centralised selling but purchases may be made either centrally or by the departmental managers.	Multiple shops are based on the principle of decentralised selling and centralised buying of products.
7. Risk There is greater risk in departmental stores as success depends on the continued prosperity of particular geographical sites.	There is dispersal of business risk as those shops which are not very successful may be closed or shifted to some other locality.
8. Type of Customers It attracts customers belonging to higher income families.	They attract customers from different income groups.

Chain Store Outlets
Retail Outlets for Petrol
BPCL 'Pure for Sure' Campaign

Petroleum companies sell their products through dealers who have retail outlets as fuelling stations or petrol pumps. These retail outlets offer other services to the consumers. The Public Sector Units in Petroleum like Indian Oil Corporation, Bharat Petroleum Corporation Limited and Hindustan Petroleum like Indian Oil Corporation. Bharat Petroleum Corporation Limited and Hindustan Petroleum Corporation Limited have different dealers all over the country. These companies have to ensure quality products to its consumers. The BPCL has started a certification campaign *Pure for Sure* which guarantees quality petrol to consumers to persuade them to switch over to their filling stations. They have addressed the problem from the retail angle. The company took full responsibility for their products and decided on a certification programme for all their dealers. This ensured quality products and increased sales at these retail outlets. Fuel retailing is also a specialised process and the BPCL has definitely recognised the potentiality of the market. A number of retail stores are coming up at these fuel stations also. These are a new concept in fuel retailing. Modern looking pumps make consumers less suspicious and they feel they are not being cheated on quantity or quality. New convenience stores are also been opened at these petrol pumps and are doing brisk business.

Source : The Economic Times

Reliance Petroleum to Start Their Own Retailing

Retail outlets in petroleum business are either company owned company operated (COCO) or company owned dealer operated (CODO) or Dealer Owned Dealer Operated (DODO). The government's decision to allow private sector to enter petroleum refineries has given rise to a demand for retail outlets for these private sector refineries. The Reliance Petroleum Ltd. (RPL) has plans to buy out dealer owned, dealer operated outlets of PSU oil majors, which is going to be part of RPLs retail network. RPL is depending upon PSU oil majors to lift sizeable quantities of its product from its Jamnagar refinery to market it. If IOC, BPCL and HPCL do not cooperate then RPL has to market its own product. But, if the government allows RPL to enter retailing Reliance will also have to set up some of its retailing infrastructure in various remote areas where sales volumes are low.

Source : The Economic Times

Indian Brands Selling in Retail Chains in London

Zodiac Clothing Company has entered into a strategic alliance with the London based retail chain Ciro Citerrio for marketing it's brands in the United Kingdom. According to industry sources Zodiac's alliance signals, the trend of Indian garment companies selling products under their own brand names. Ciro Citerro was recently taken over by the Landmark group which runs the lifestyle chain of stores in India and they also have many retail outlets in the Middle East. Landmark apparels sell under the Citerro brand names. Zodiac is the first Indian company to strike an exclusive alliance to market it's products in Europe.

Tata Steel into Retail Business

Tata Ryerson, a joint venture between Tata Steel and Ryerson International of USA has launched its first retail outlet in Kolkata. This is the first time that steel and steel products will be retailed out of its own outlets. They have diversified into other metals like aluminium, zinc, copper. They cater to the requirements of consumers of industrial materials. The Tatas would be able to effectively cut down on the different points of distribution that stand between the manufacturing activities on sale and offer a better price to the customer. At the same time they would get a better value for their products.

Source : The Economic Times

3. Mail Order Retailing

As distinguished from other forms of retailing, in mail order retailing, business transactions are made through postal communication without any personal contact with the buyers. This type of arrangement sometimes is called *shopping by post* and from the view point of sellers, it may be described as *selling by post*. Under this type of trading, goods are supplied to the customers without the help of middlemen and without the customers having to undertake a journey to the retailer. The sellers approach the potential buyers through advertisement and mail publicity, i.e. by sending circulars, catalogues, price lists, samples, booklets etc. The customers are required to place their orders by post. A detailed mailing list containing names and addresses of the potential customers is maintained by mail order house. It is revised and supplemented from time to time.

Since it is not possible for the buyers to make a personal inspection of the goods only standard consumer articles with trade marks and brand names are most suitable for this system or retailing. Besides, goods which are perishable in nature, or which may be easily damaged in transit, or which is very heavy and bulky are not usually traded through mail. Further mail order trading cannot

be successful unless people are educated.

There are three types of mail order houses, which are:

(a) The manufacturing type: Where the manufacturers themselves sell directly to the customers, through mail. This way they can avoid middlemen and economies on the cost of sales.

(b) The departmental type: Some of the departmental stores, in addition to selling through different departments, undertake to supply goods by mail directly to customers.

(c) The middlemen type: This is the most common type of mail order business, where the retailer receives orders by post and execute them after buying from manufacturers or wholesalers.

Advantages

Advantages are mentioned below:

(i) Limited capital: Mail order business can be started with limited capital as there is very little need for investment in shops, displays and large stocks.

(ii) Middlemen avoided: As middlemen can be avoided under the manufacturing type of mail order business, the cost of marketing is minimised.

(iii) Cash basis: As the goods are sold on cash, there is no risk of bad debts.

(iv) Wide scope: Goods can be supplied through mail even to far off places throughout the country. This opportunity widens the scope of the business greatly.

(v) Convenience: This form of business can be very convenient for the consumers as goods are delivered at their place by post, and they are not to waste time and effort in going to shops.

(vi) Handled from any place: This type of business can be handled from any place where the postal services are available.

(vii) Minimum overhead expenses: As the overhead expenses are minimum in this type of business, it is possible to fix prices at a reasonable level so as to attract large numbers of customers.

Limitations

Limitations are the following:

(i) No personal inspection: The buyers do not have the opportunity of personally inspecting the goods before buying.

(ii) No personal contact: Because of lack of personal contact many customers do not have confidence in this type of trading.

(iii) Not suitable for all items: Bulky items, or perishable items, or items requiring demonstration cannot be sold through mail order business.

(iv) Delay in delivery: It is not possible for the customers to have immediate delivery of the goods. They have to bear with the delay in delivery through mail.

(v) Postal delay: There is great dependence on the postal department in this type of business and chances of undue delay or pilferage of goods in transit is always possible. Now, this

limitation has been overcome due to availability of private courier services.

(vi) Outdated catalogues: In cases of items where prices are subject to frequent change, there is a quick need for updating the catalogues etc. which adds to the cost of sales.

(vii) Limited scope: There is limited scope for this type of business in places which are not well connected through postal services or where people are illiterate.

4. Consumer Cooperative Store

Recently, the cooperative form of retailing has become very popular in certain parts of our country. Under this system the consumers themselves come together to form a cooperative society themselves. The society enrols members either from the general public or particular groups like the employees of an organisation. The objective is to save the members from exploitation by middlemen as regards price, quality, weight etc. Retail stores run by cooperative societies formed by consumers are known as consumers cooperative stores. Such stores are owned and operated by consumers so as to make available goods at a reasonable price. They may deal in all types of consumer goods of daily use including grocery, stationery, utensils, dress materials, medicines, etc. The articles are procured from wholesalers or manufactures. The capital is raised by issue of shares to the members. The management of the store is entrusted to an elected managing committee. Each member has a single vote, irrespective of the numbers of shares held.

In order to start a consumer cooperative store at least 10 people have to come together and form a voluntary association and get it registered under the Cooperative Societies Act. The store may sell goods to members as well as non-members but a purchase bonus is usually distributed to members whenever they make purchases for themselves. Goods are sold only on cash basis. The profit earned is distributed among members as dividend.

Advantages

Advantages are mentioned below:

(i) Reasonable prices: It provides consumer goods at reasonable prices by eliminating middlemen in the distribution of the products.

(ii) Low marketing costs: The marketing costs are very reasonable as there is no need to have any large establishment and goods are sold only on cash basis.

(iii) Check on monopoly: Through cooperative stores it is possible to have some check on monopoly and wasteful competition.

(iv) Democratic management: Because of the democratic pattern of their management the cooperatives prove to be good educators of cooperative management.

Limitations

Limitations are the following:

(i) Lack of business training: There is lack of business training or expertise in the people entrusted with management of the stores.

(ii) Dependence on honorary services: There is great dependence on the honorary services of some members for the management of the stores.

(iii) Lack of finance: Lack of adequate financial resources of the store usually affects its functioning.

(iv) Lack of storage facilities: Lack of proper warehousing facilities might also adversely affect their usefulness.

5. Super Markets

Super markets are large retail stores selling a wide variety of consumer goods under one roof. These are also organised by cooperative societies. The goods traded may include consumer goods, grocery, cloth, utensils, electrical appliances, small tools, medicines, etc. Now-a-days, a large variety of products of different brands are available in super markets. The stores are operated either on the basis of self-service or by salesmen in different counters. A super market is also a large scale retailing organisation but, it is generally, established as a private sector enterprise not by a co-operative society. The consumers cooperative stores are run on a small scale whereas super markets are large size organisations run on purely business considerations. Some of the important features of super markets are:

- They deal in a wide variety of products, food items, groceries, as well as durable consumer goods;
- These are often run on self-service basis. The customers themselves select the goods they require and make payment at the cash counter;
- These are low cost retail institutions as compared to other types of retail stores;
- Goods are sold on cash basis only;
- These are generally, opened at central locations where large numbers of buyers may reach;
- These are organised by co-operative societies.

Advantages

(i) Convenience: They provide great convenience to buyers as a wide range of products are offered for sale which enable them to buy most of their requirements at one place.

(ii) Lower prices: The prices charged in super markets are relatively lower because of economies of large scale operation and elimination of middlemen.

(iii) Wide choice: They offer a reasonable choice to the consumers resulting in large turnover of goods.

(iv) Cash sales: As all sales are made on cash basis, there is no risk of bad debt.

Limitations

(i) No credit: There is no facility of credit sale to customers.

(ii) High costs: Generally, there are high administrative costs in a super bazar.

(iii) Low initiative: Lack of initiative on the part of employees is also noticeable.

6. Franchise

Franchise is an agreement between two parties. You must have seen certain shops in different markets with the same name selling the same products and maintaining a similar type of shop décor. These shops are the result of a franchise agreement between the parent company and owner of an individual business unit. The parent company provides the right to use its trademark, in return for a payment to an individual business unit. The parent company is called the Franchiser and the business unit who is given the right is called the Franchisee.

Franchising is based on a continuing relationship and is a contractual association between the franchiser and franchisee. The franchiser may be a manufacturer, wholesaler or service organisation. The franchisees are independent business units who buy the right to own and operate a unit using the franchisers' trademark.

How does a franchising system work? Franchise agreements are usually, based on a unique product, service or on a trade name, or patent or goodwill that the franchiser has developed. Otherwise, why will a franchisee pay to use a trademark unless there are some advantages attached to it? The franchisee gets an edge over competitors in the domestic market as a brand identity of the product has already been established by the franchiser.

In India, franchising has been popular in fast food chains, health and fitness centres, education and training centres, and departmental stores of international repute selling international brands.

There may be more than one franchisee and their operations are planned, directed and controlled by the parent company i.e., the franchiser. The franchiser can grant a licence or allow use of its trademark or brand name to more than one business unit as in the case of McDonald, Bennetton, NIIT. The main features of a franchise are:

- The franchiser owns a trade or service mark and licenses it to the franchisee.
- The franchisee pays for the licence and becomes a part of the network. An initial payment has to be made and then a regular licence fee. There may be an agreement on the percentage of sales or profit to be given monthly or annually.
- The franchiser usually, provides all marketing support and proper equipment and systems for doing business in the requisite manner. The parent company virtually sets up the business for the franchisee.
- There may be a clause in the franchise agreement for the franchisee to follow company policies regarding modes of operation of business. The agreement may also require the franchisee to maintain a particular kind of décor in the place of business.
- The franchiser may give training

Franchise Agreement

One of the most successful franchise systems of all time is McDonalds. McDonalds has the same kind of décor in all its outlets. The parent company decides to maintain a certain décor and insists on all the franchisees to follow. This helps in immediate identification of brand name. Cost, Quality, Cleanliness and Value for money are the four pillars on which McDonalds, has built its reputation in the market. It expects all its franchisees to strictly follow the company's policies in all respects. The terms of agreement also contains a clause for training the personnel working in the organisation. This is provided to maintain uniformity of customer services in all its outlets.

to all the personnel working in the franchisee organisation. This is very common in restaurants and fast food chains. The franchiser takes the responsibility for employee development and training in future also. Employees are trained to use innovative techniques of production. They may also be sent to the parent company for further development and training.

Franchising is mutually beneficial to both the franchiser and the franchisee. The advantages to the franchiser are:

- The franchiser is able to expand the business with little extra cost since the franchisee provides the capital for the outlet. The franchisee also pays a lumpsum to the franchiser.
- The franchiser is able to enhance the goodwill and reputation of the business since the franchisees are highly motivated and more concerned about succeeding. They have a large financial stake in the business as they have invested huge amounts for the retail outlet and licence fee. This ensures the survival and success of the business and the name of the franchiser is carried on.
- The franchiser gains wider acceptance of its brand name as the franchisees take care to follow the parent company's guidelines. They abide by the company's policies and their methods of operating a business which have already proved to be successful but the franchiser's reputation also remains intact.
- Franchisers get direct feedback from franchisees as they are more familiar with the local community and conditions prevailing in the local market. They can advise the parent company about specific consumer tastes and preferences. For example, international fast food chains have adapted their products to local tastes.

Benefits to the Franchisee

(i) Franchisees benefit from buying into a well known business and accepted brand name. They can use the parent company's trade

name for attracting customers. A ready market is available as the reputation of the business has already been established.

(ii) Management assistance and training is provided to the franchisee. Store layout guidance, technical know-how and marketing techniques are all part of the training that is provided.

(iii) The franchisee gets the benefit of technological upgradation in its own operations without investing huge amounts. The parent company makes huge investment in research, new product designs and innovations.

(iv) A high degree of quality control is exercised by the parent company. The franchisee gets the advantage of efficiency in operations, a superior finished product and a high degree of customer satisfaction.

9.7 Non-Store Retailing

Till now, we have discussed sales taking place through retail stores. In other words, the consumer purchases products from a store or shop. But these days a growing number of sales are taking place outside stores where the manufacturer or direct selling agency sells products directly to the consumer. Sales which do not take place in a store or a shop come under the category of non-store retailing.

These retailing activities result in exchange of goods for cash or on credit outside the confines of a retail store. While majority of people prefer to go to a shop for their requirements, there are a section of people who would like goods to be delivered at their doorstep. These sales may be made without having a shop as a base. They involve a number of persons to reach out to consumers. Now-a-days, many businesses are using this method to push their sales. We shall consider here three types of non-store retailing: direct marketing, telemarketing, internet marketing.

9.7.1 Direct Marketing

Some businesses concentrate on direct marketing to sell their products to customers. Direct marketing means reaching out to customers using advertising as a method of promotion to sell products. Customers in turn, purchase products without visiting a retail store. It involves informing, soliciting or approaching the customer directly. This is made possible by using advertising extensively to inform the customer about products. The products are advertised through one or more media viz.; radio, television, newspapers, magazines, catalogues and direct mail. Customers can place their order with specifications by telephone or mail. Direct marketing, therefore includes all those activities undertaken by an organisation to reach out to customers.

There are many forms of direct marketing which are direct mail, catalogue retailing and televised shopping.

(i) Direct mail: Firms send letters, cards, brochures by mail informing prospective customers about the range of products and prices. Customers are to respond by mail or telephone to place their order. The product may also be advertised through various media and the customer can ask for detailed information. Credit cards, club memberships and magazines are largely sold in this manner. Direct mail can be used for selling well-known goods. Well-known and standard goods have an easier customer acceptability and the customer is more confident about them.

(ii) Catalogue retailing: Firms mail catalogues to prospective customers on a regular basis. The sellers first identify the buyers and send catalogues and other unsolicited information to them. The catalogues contain detailed information on the range, price and description of the product. Usually, publishers use this method to sell their books. The catalogue is well-designed and divided into sections to suit the needs of different readers. It contains an abstract of the books and their authors along with the market prices and discounted price if any. For products like books, this method is very popular as the customer can order at leisure after reading the contents carefully.

(iii) Televised Shopping: The

Direct Marketing for Small Business
Do's and Don'ts of Direct Mailing

Prepare a Mailing list and send to a select member of clients or prospects. Wait for an accepted response before mailing to the remainder of your list. This will keep your costs down.

Do's

- Use direct mail as part of your regular marketing as it is one of the most cost effective ways to reach your target audience.
- Make your direct mail simple and easy to read. Get your message across quickly and concisely.
- Make sure your direct mail goes to right person. Keep your client list up to date. Follow up with a telemarketing campaign

Don't

- Don't try to send direct mail by yourself if your time is valuable and you have too many pieces to send. A lot of time is spent in producing, printing folding, staffing, 250 to 500 letters. Direct mail houses do the job quickly and are more cost effective.

Source : The Economic Times

firm advertises its products on various TV channels. The TV channel shows films about the range of products available. The film is made lively and interesting and a demonstration of the product is given. All details about the products with prices are displayed on the screen. A list of telephone numbers in each city is also displayed for customers to order on telephone. This media is suitable for specialised products which are electronic and mechanical in nature. The technicalities and the working of the product can be demonstrated.

Direct marketing offers certain advantages. It provides shopping convenience and saves valuable time of busy people. It is becoming popular because of working families and hectic time schedules. The other advantage is that it eliminates middlemen. The firm sells products directly to customers without having to go through the normal route of producer to wholesaler to retailer and then finally consumers. The middleman's profit is not added to the cost of the product.

But, this method also suffers from a number of limitations. There is a lot of scope for giving misleading information about the product and deceiving the customer. The advertisement framed or film shown can be very misleading and exaggerated. Customers may be quick to order certain products after seeing a demonstration on TV and later on be very disappointed. Customers have to place their orders without seeing or trying the product.

Catalogues and direct mail are very expensive methods. They require considerable planning and preparation before they are sent. The content of the catalogue has to be well designed and meaningful.

Direct marketers have to offer money back or return packages to gain the confidence of customers.

Direct marketing should be distinguished from direct selling. The main point of difference between direct marketing and direct selling is in the promotion method used. Direct marketing uses advertising extensively to inform consumers whereas direct selling depends upon establishing personal contact with the consumer.

Direct selling is defined as a personal contact between a sales person and a consumer away from a retail store. The sales person may not be an employee of the company selling the products. The company establishes a network of sales people and sells its product directly to consumers. Many companies have been very successful in their campaigns. They are Avon, Tupperware, Amway, World Book International. These products are highly priced and of superior quality. The consumers, therefore, would like to scrutinise the product and understand its working. Various methods are employed for effecting such sales.

9.7.2 Telemarketing

Telemarketing in simple terms means contacting a person on telephone and persuading a prospective customer to buy a product. It implies relying exclusively on telephone with no back

Direct Selling Vs Direct Marketing

Eureka Forbes has been a pioneer in using personal selling or direct selling as an effective technique for selling. Their salespersons went door to door and demonstrated the use of the product i.e., a vacuum cleaner which was a new concept in India. They later on sold a water purification gadget, Aqua Guard which they claimed killed the bacteria in water and made it fit for drinking purposes. They relied only on direct selling initially. Subsequently, they have started advertising their products also. But they do not have a retail outlet. They have continued to use direct selling techniques also.

Asian Sky Shop has used Direct Marketing i.e., Televised Shopping to sell their products to consumers. They give a full demonstration of the working of the product with a list of contact phone numbers in every city. A film is produced with a story line and a lot of time and effort goes into it to make it interesting.

up material to effect sales. Telemarketing actually excludes the usage of literature and personal visits. But, in India, the sale is usually, finalised after the customer has received more details and a personal visit is arranged with a representative of the company.

The firm or company selling products employs its own salespersons and gives them intensive training. The salespersons should have complete knowledge about the company and its products and the terms and conditions of sale. The company has to first identify its target market. A list of customers can be made from the local directory. The sales person employed should also be trained in the art of conversation, as the person has to initiate the sale over the telephone.

Products and services which can be bought without seeing or do not require close scrutiny are suitable to be sold in this manner. These are usually, magazine subscriptions and club memberships. Companies engaged in providing financial services are also selling credit cards and other services. Many multinational companies are setting up their telemarketing centres here in India. This has created vast employment opportunities for young people. Telemarketing is very popular with companies selling time sharing resorts. Sales representatives of these companies ring up prospective customers explaining, their terms and conditions. If they get a favourable response the sale is finalised over the telephone and a personal meeting may be arranged to settle the deal.

The main advantage of telemarketing is of convenience from the consumer's point of view. They save a lot of time by making a purchase over the telephone. Computer systems today have made it easier by playing recorded messages and then record the information that consumers give. Consumers may give their credit card number and the sale is finalised

Telemarketing has many drawbacks also. Some calls come at odd

hours. Customers can get very irritated with such unsolicited calls. The sales representative may not be very explicit at times and a different impression may be conveyed to the customer. High labour costs are associated with telemarketing. People have to be employed round the clock for making calls. Computerised systems used in telemarketing are expensive in India and are not cost effective. Inspite of perceived disadvantages the system is growing.

9.7.3 Internet Marketing

Advanced technology affects both consumer behaviour and retail management. Now-a-days, online retailing services are offered by computerised networks. The consumer has to log on to the internet, go to a particular website and order from the information given there. There are *click* boxes to take customer orders, bill credit cards and initial purchase orders. The retailer gives a list of their products on the website and the consumer can electronically browse through the items, view the products and correct prices. The consumer can also make price comparisons, use coupons, make shopping lists and

Internet Shopping — Picking Up

A global survey carried out by Taylor Nelson Sofres in 36 countries has ranked India 32nd in terms of internet usage. The survey reveals that 13 per cent of India's adult population accesses the internet. The global average is 31 per cent but 13 per cent also shows encouraging growth and there is a potential for e-commerce in the country.

In terms of online shopping and e-commerce India ranks 33rd with only 2 per cent compared to an average of 15 per cent. USA heads the list with 33 per cent internet users shopping online, followed by Germany, Great Britain, Norway and Korea.

Online shopping in India is starting to grow and it's potential is now being recognised by many internet users. The survey revealed that consumers gave a number of reasons for not buying online. Some of them were:

- It's more secure buying goods and/or services in a store (33 per cent).
- It's too difficult/lack of knowledge (17 per cent).
- Easier/more for to buy goods in a store (14 per cent).
- You don't know what you get (13 per cent).
- Don't trust online brands/lack of trust worthiness (11 per cent).
- Don't want to give credit card details/security problems (11 per cent).
- Prices too high/expect lower prices on the internet (10 per cent).
- Time to deliver goods is too long/other delivery problems (10 per cent).
- Products/services found on internet are not very interesting (9 per cent).
- Did not pass the credit check (23 per cent).
- Other reasons (22 per cent).

Source : The Economic Times

leave special purchase instructions. The consumer can place an order by E-mail, telephone or fax and the retail store delivers the order within a stipulated time. Retailers have realised they must satisfy consumer needs and wants and establish productive relationships with them. Now-a-days, you may notice in many advertisements retailers give their website address where you can visit them for more information and also communicate with them. Many retailers are using computerised systems to satisfy busy professionals and working families. Publishers and booksellers find this method very suitable for selling books, magazines and journals.

International buying and selling activities are also carried on through the internet. It is very useful for importers and exporters and saves valuable time and money.

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SUMMARY

Trade, as we all know, is the oldest profession in the world. By trading we mean sale of goods and services for a profit.

Internal trade: Trade which takes place within a country is called internal trade. Goods can be freely bought and sold within the national boundaries of a country. Internal trade can be classified into two categories, viz.; wholesale trade and retail trade.

Wholesale trade: Wholesalers form an important link between the producer and retailer and are essential for the distribution of goods. They perform a number of functions which include the sale and all activities related to the sale of goods to retailers and other business organisations.

Functions of wholesaler: Wholesalers perform several functions, thus, relieving the manufacturer and retailer of a number of tasks: (i) Buying and assembling; (ii) Subdividing or breaking the bulk ; (iii) Warehousing; (iv) Transportation; (v) Financing; (vi) Selling and promoting; (vii) Risk bearing; (viii) Market information; and (ix) Grading and packaging.

Services of wholesalers: Wholesalers provide services of value to manufacturers and retailers by filling the gaps between the seller (producers) and the buyer (retailer/final consumer).

Service to manufacturers: (i) Sales persons to manufacturers; (ii) Economies of scale; (iii) Market information; (iv) Storage; (v) Financial support; (vi) Concentration on production and (vii) Physical distribution.

Service to retailer: (i) Availability of goods; (ii) Financing; (iii) Risk taking; (iv) Management assistance; and (v) Transportation.

Retail trade: The retailer is the last link in the distribution channel. Any organisation or individual selling to the final consumer or end user is doing retailing.

Functions of retailers: Retailers perform the important task of reaching out to the consumer and providing them with a variety of services: (i) Assortment of products; (ii) Provide information; (iii) Convenient location; (iv) Pricing; (v) Display arrangement; (vi) Credit arrangements; (vii) Sales assistance; and (viii) Demonstration and after sales service.

Classification of retailers: Retailers are classified according to their size, product mix, prices, services, ownership and site.

Types of retail trade: Retail organisations may be classified into two categories: (i) Itinerant retailers and fixed shop retailers; (ii) Large scale retailers.

Itinerant retailers: Itinerant traders are found in all cities, towns as well as villages. The most common types of such traders are the following:

(i) Hawkers and pedlars: Hawkers and pedlars are traders who move around from place to place selling their goods. They usually, carry their goods in a bag or on a cart or a cycle or on animals.

(ii) Periodic market traders: These traders sell their articles on fixed days in different market places. A special feature of theirs is that they come with a periodicity and their weekly market day is fixed.

(iii) Street traders: These retailers generally, display their articles on busy street corners, bus stands, pavements, or in and around offices or commercial areas. They sell articles like books, diaries, pens, newspapers, magazines etc.

Fixed shop retailers: These retail shops are of six types:

(i) General stores: These stores deal in items of daily use, like groceries, confectionery, stationery, soft drinks, etc. They have a large variety in each line of goods.

(ii) Single line stores: These stores deal in a general category product line. The product line may consist of readymade garments, textiles, medicines, shoes, stationery or books.

(iii) Speciality stores: These stores deal in a particular product line only. The products include certain special products or special branded products.

(iv) Street shops: These shops can be defined in terms of their location. Street shops are those shops which are situated at street crossings or on main roads or on corners of colonies. They may be set up in corridors of markets also.

(v) Second-hand goods shop: These shops sell second-hand goods of different kinds like furniture, books, clothes and other household articles. Since they are used goods, they are not priced heavily.

(vi) Seconds shop: These shops sell goods which are not produced according to the required specifications. These goods always have some defect in them and hence, they are termed as seconds goods.

Large scale retailers: In large scale retailing, it is the volume and variety of goods stocked that is large. Large scale retailers operate on a large scale.

1. *Departmental store:* It is a retail organisation which offers a variety of products in separate departments under one roof.

Advantages: (i) central location; (ii) shopping facility; (iii) benefits of large scale; (iv) expert services; (v) financial resources; and (vi) services to customers.

Limitations: (i) Lack of personal attention; (ii) High operating cost; (iii) A

departmental store requires huge capital to be invested; and (iv) Many people do not like to travel a long distance.

2. *Multiple shops or chain stores :* Multiple shops refer to retail shops owned and controlled by a single organisation and located in different parts of a city or throughout the country. These shops are also known as chain stores. Chain stores deal in a limited variety of products.

Advantages: (i) Economies of scale; (ii) Standardised products; (iii) Spreading of risk; (iv) Attractive location; (v) No bad debts; (vi) Easy identification; and (vii) Centralised advertising

Disadvantages: (i) Individual tastes not satisfied; (ii) Limited range of goods; (iii) Inflexibility of operation; (iv) Absence of initiative; and (v) Divided attention.

Departmental store Vs chain stores: There are certain differences between the two, which are explained below: Objects, Volume of investment; Credit/Cash basis; Location; Prices; Centralisation of activities; Risk; Type of customers.

3. *Mail order retailing :* As distinguished from other forms of retailing, in mail order retailing, business transactions are made through postal communication without any personal contact with the buyers.

Advantages: (i) Limited capital (ii) Middlemen avoided; (iii) Cash basis; (iv) Wide; (v) Convenience; (vi) Handled from any place; and (vii) Minimum overhead expenses.

Limitations: (i) No personal inspection; (ii) No personal contact; (iii) Not suitable for all items; (iv) Delay in delivery; (v) Postal delay; (vi) Outdated catalogues; and (vii) Limited scope.

4. *Consumer cooperative stores:* Under this system the consumers come together to form a cooperative society themselves. The society enrols members either from the general public or particular groups like the employees of an organisation.

Advantages: (i) Reasonable prices; (ii) Low marketing costs; (iii) Check on monopoly; and (iv) Democratic management.

Limitations: (i) Lack of business training; (ii) Dependence on honorary services; (iii) Lack of Finance; and (iv) Lack of storage facilities.

5. *Super markets:* These are large retail stores selling a wide variety of consumer goods under one roof.

Advantages: (i) Convenience; (ii) Lower prices; (iii) Wide choice; and (iv) Cash sales.

Limitations: (i) No credit; (ii) High costs; and (iii) Low initiative.

6. *Franchise:* It is an agreement between two parties. Franchising is based on a continuing relationship and is a contractual association between the franchiser

and franchisee. The franchiser may be a manufacturer, wholesaler and / or service organisation. The franchisees are independent business units who buy the right to own and operate a unit using the franchisers trademark. In India, franchising has been popular in fast food chains, health and fitness centres, education and training centres, and departmental stores of international repute selling international brands.

Non-store retailing: Sales which do not take place in a store or a shop come under the category of non-store retailing. These retailing activities result in exchange of goods for cash or on credit outside the confines of a retail store.

Direct marketing: Some businesses concentrate on direct marketing to sell their products to customers. Direct marketing means reaching out to customers using advertising as a method of promotion to sell products. There are many forms of direct marketing which are direct mail, catalogue retailing and televised shopping. Direct marketing offers certain advantages. It provides shopping convenience and saves valuable time of busy people. But, this method also suffers from a number of limitations. There is a lot of scope for giving misleading information about the product and deceiving the customer. Catalogues and direct mail are very expensive methods. Direct marketers have to offer money back or return packages.

Telemarketing: Telemarketing in simple terms means contacting a person on telephone and persuading a prospective customer to buy a product. It implies relying exclusively on telephone with no back up material to effect sales. The main advantage of telemarketing is of convenience from the consumer's point of view. They save a lot of time by making a purchase over the telephone. Telemarketing has many drawbacks also. Some calls come at odd hours. Customers can get very irritated with such unsolicited calls. The sales representative may not be very explicit at times and a different impression may be conveyed to the customer. High labour costs are associated with telemarketing.

Internet marketing: Now-a-days online retailing services are offered by computerised networks. The consumer has to log on to the internet, go to a particular website and order from the information given there. Many retailers are using computerised systems to satisfy busy professionals and working families. Publishers and booksellers find this method very suitable. It is very useful for importers and exporters and saves valuable time and money.

EXERCISES

Short Answer Type Questions

1. What is meant by internal trade?
2. How do wholesale and retail trade form part of internal trade?
3. What purpose is served by wholesalers providing warehousing facilities?
4. How does market information provided by the wholesale benefit the manufacturer?
5. How does the wholesaler help the manufacturer in availing the economies of scale?
6. Distinguish between single line stores and speciality stores. Can you identify such stores in your locality?
7. How would you differentiate between street traders and street shops?
8. What are the various forms of direct marketing?
9. In spite of the advantages that direct marketing offers, it is not very popular. Explain why?
10. How far has telemarketing been successful in India?
11. What are the benefits of a franchising system from the point of view of the franchisee.
12. Why do you think non-store retailing is growing so fast? Can it ever replace the retail shops?

Long Answer Type Questions

1. Itinerant traders have been an integral part of internal trade in India. Analyse the reasons for their survival in spite of competition from large scale retailers.
2. Discuss the features of a departmental store. How are they different from multiple shops or chain stores.
3. Why are consumer cooperative stores considered to be less expensive? What are its relative advantages over other large scale retailers?
4. Imagine life without your local market. What difficulties would a consumer face if there is no retail shop?
5. If the wholesaler is eliminated. What difficulties do you think the manufacturer would have to face?
6. Why has franchising become so popular in recent years? What are the limitations of the system?

Project Work

1. Identify various fixed shop retailers in your locality and classify them according to the different types you have studied.
2. Do you have any retailers selling second-hand goods in your area? Find out the category of the product that they deal in? Which products are suitable for resale? List some of your findings. What conclusions do you draw?

3. Do you observe any difference in the retail business of yesterday and the times to come? Prepare a brief write up and discuss it in class.
4. Have you observed any retail shop based on a franchise agreement come up recently? Find out the terms of agreement, if you can, and other details from the shop. Observe the décor around and prepare a brief summary of your findings.
5. Find out the names of some retailers selling on the internet. What are their distinguishing features?
6. From your own experience, compare the features of two retail stores selling the same product. For example, the same product being sold at a small scale retailer like a general store and in a big store like a departmental store. What similarities and differences can you identify in terms of price, service, variety, convenience etc.

CHAPTER 10

External Trade

LEARNING OBJECTIVES

After studying this chapter, you should be able to :

- state the nature and importance of external trade;
- explain the procedures of export and import trade;
- appreciate the significance of various export-import documents;
- analyse the export promotion measures provided by the government of India;
- describe the features of export processing zones and special economic zones.

10.1 Introduction

You have learnt about internal trade in the preceding chapter. Many firms expand operations and look for markets outside the country. They start trading with firms in other countries. Countries and governments start exchanging goods and services with each other. This gives rise to external trade between countries. In this chapter you will learn the nature and importance of external trade, export-import procedures, significance of export-import documents and various export promotion measures.

10.2 Why External Trade?

Every country in the world is blessed with different kinds of natural resources. The country may possess mineral resources, water resources, labour and capital, technological capabilities, managerial abilities, etc. These factors facilitate the production of goods and services in a particular country. The country, which is endowed with these factors may produce some goods more efficiently than others. For example, Japan may produce electronic goods more efficiently than India and India may produce agricultural products more efficiently than Japan. Thus, India can buy electronic goods from Japan and sell agricultural products to Japan. Both the countries are benefited by trading the goods to each other because they can produce them at a relatively cheaper price. In this way, Japan may attain specialisation in electronic goods and India may be specialised in agricultural products. Therefore, Japan may produce and export electronic goods to India because Japan has advantage in doing so and it can import agricultural products from India because it has disadvantage in producing agricultural products. India can produce and export agricultural products because she has advantage in doing so and she can import electronic goods because she has disadvantage in producing the electronic goods. Thus, international trade facilitates efficient utilisation of factors of production.

10.3 Nature of External Trade

External trade refers to buying and selling of goods and services between two or more countries. Since two countries are involved in external trade, the procedures, mode of payment, documentation, etc. differ from those of internal trade. For example, if you sell a pen in India, the payment is made in Indian currency; the delivery is made in India. The buyers and sellers are accustomed with the trade procedures. If you have to sell pens in America, you face a different trading environment. For example you have to fill up the documents required for exporting pens from India and get approval from government authorities like Export Inspection Agency, Customs Authority, etc. The goods are to be dispatched to America and the payment will be received in dollars. In the same way, if

you buy pens from America, you are required to follow the documentation procedures for importing them into India and make the payment in dollars. Thus, in external trade the country faces different government regulations, economic policies, monetary systems and documentation procedures.

10.4 Importance of External Trade

External trade is often considered to be an important means of economic growth. Exports are required to earn foreign exchange and finance imports, which are needed to meet the developmental requirement of country. Thus, exports and imports help in accelerating the economic growth of the country. South Korea, Singapore, Hong Kong, Malaysia, and many other countries have grown faster by active participation in external trade. In specific terms, following are the importance of foreign trade:

(i) Competitive use of country's resources: Every country has natural resources, which it tries to exploit and produce certain goods and services. Attempt is made to produce the goods most efficiently. Gradually, the country attains specialisation in producing certain types of goods. A country facing competition in world markets uses its resources in the best possible way. The competitiveness also forces the firms to achieve higher productivity and cost efficiency.

(ii) Accelerates economic growth: External trade accelerates the economic growth of the trading countries. The firms have to cater to larger markets and supply quality products to foreign markets. In order to meet the growing demand, production activities are accelerated in the country. Enhanced production operations accelerate economic growth.

(iii) Enhances competition: External trade also enhances competition in the domestic market. In order to meet competition, firms have to introduce new technology, better management tools and improved production processes. The firms try to innovate better production and marketing techniques, which lead to more intensive competition in the domestic market. In order to compete with foreign goods, domestic firms try to improve the quality of their products, which again builds up competition within the country.

(iv) Economies of scale: Firms engaged in external trade, build up large productive capacity to meet foreign demands. The large scale production helps the firms to derive economies of scale and reduce the cost of production.

(v) Increase in employment: Foreign trade accelerates the production operations in the country. Firms require more people to meet the increased production requirement. This increases the employment potential in the country.

(vi) Brings efficiency: The firms have to compete with foreign companies as regards quality and price

of goods. They are compelled to be more cost efficient and improve the quality of products. They adopt new production techniques to supply better products. This makes for all round progress.

(vii) Stability in prices: External trade helps in bringing about stability in prices of domestic products. For example, if the prices of a commodity decline due to increased supply the country may export its surplus production with a view to prevent the declining trend in price. In the same way, if prices of any commodity tend to increase due to short supply, the rise in prices may be controlled by increased imports. Thus, foreign trade may be used as an instrument for price stabilisation.

(viii) Technological upgradation: The domestic firms have to produce superior quality products for the foreign markets. This invariably requires upgradation of technology. Firms thus, have to update or introduce new technology to produce better quality products.

(ix) Opportunity to import strategic goods: The country gets opportunity to import goods which are not available internally or which are expensive. For example, India imports petroleum from Middle East countries to meet her demands. Life saving drugs, computer chips, mobile phones, etc. are also imported.

(x) Promotes global understanding: External trade provides opportunity to a country to interact with other countries on a continuous basis. The country comes closer to other countries and understands the cultural dimension, work culture, attitude, skills and knowledge of people in those countries. This understanding helps in reducing conflict among countries and promotes a healthy relationship among them.

10.5 Export Procedures

Every exporter has to undertake market survey and identify the market for exporting goods. The export procedure involves the following steps:

(i) Obtaining importer's exporter's code (IEC) number: The export and import procedures require the importer's and exporter's code numbers. This number is to be filled in various export-import formalities. In order to obtain this number, one is expected to apply to the Regional Import-Export Licensing Authority in the prescribed form. The application should be submitted with the following documents:

- Profile of exporter/importer;
- Bank Receipt for requisite fee;
- Certificate from the banker on the form;
- Two copies of photographs attested by banker;
- Detail of non-resident interest;
- Declaration about applicant's non-association with a caution listed firm.

If the Regional Import-Export Licensing Authority is satisfied with the formalities, IEC number is issued.

(ii) Obtaining Registration-cum-Membership Certificate (RCMC): This certificate is required for obtaining facilities, benefit or concessions provided under the Export-Import Policy (EXIM policy). This certificate is issued by the Export Promotion Council/Commodity Boards/Federation of Indian Export Organisation/Agricultural and Processed Food Products Exports Development Authority/Marine Products Export Development Agency, etc. Application has to be made to the above concerned authority in the prescribed form along with Importer-Exporter Code Number, Bank Certificates and any other specified document. If the authority is satisfied, the RCMC would be issued.

(iii) Market research: After obtaining an IEC No. and RCMC, the exporters start exploring the export markets. They conduct surveys and market research to procure the export order.

(iv) Confirmation to importer: After receiving the export order, the exporter examines it carefully. When it is found satisfactory, the exporter confirms it to the importer.

(v) Manufacturing goods: Exporters then start manufacturing or procuring the goods as required by the importer. Exporters should adhere to the specification given by the importer for supply of the goods.

(vi) Excise clearance: As you know the materials required for the manufacture of goods are subject to excise duty under Central Excise Tariff Act. Export goods are either exempted from the excise duty or this duty if paid, is refunded back to the exporter. Therefore, exporters apply to the Excise Commissioner along with the documents like Invoice and AR4/AR5 Forms. If Excise Commissioner is satisfied, excise clearance is given. When goods are shipped, the claim for refund of central excise duty is made to the Assistant Central Excise Commissioner who has jurisdiction over the factory. The Assistant Central Excise Commissioner examines the claim carefully. If she/he is satisfied, the claim is sanctioned to the exporter.

(vii) Pre-shipment inspection and quality control: Quality is an important element of export marketing. Exporters must export goods of international standards. Quality control is exercised in the production of export goods in accordance with the export quality regulations and the buyer's specifications. In India, the Quality Control and Inspection Act provides for compulsory quality control and pre-shipment inspection. Government of India from time to time notifies the items, which are subject to compulsory quality control and pre-shipment inspection. Government also prescribes quality standards for products involving safety or health hazards. In the export of these commodities, minimum prescribed standards must be satisfied.

Export Inspection Council and its agencies are involved in maintaining the quality and providing inspection certificate to the exporters. The

inspection certificate is required by the customs authority for the shipment of the goods. There are three methods of pre-shipment inspections. They are as follows:

(a) Consignmentwise Inspection: In this method, the exporter approaches the Export Inspection Agency for the inspection of the export goods. Each consignment is inspected by the Inspector of the Export Inspection Agency according to the specifications and standards. If the inspector finds the goods satisfactory, inspection certificate is issued to the exporter.

(b) In-process quality control: If an export unit possesses the required infrastructure for manufacturing products of standard quality, it is approved as exportworthy unit by Export Inspection Agency. The exportworthy unit is allowed to inspect and clear goods for export. The Export Inspection Agency issues the inspection certificate after declaration by the exportworthy unit.

(c) Self certification: The reputed firms which possess necessary mechanism for quality assurance,

New Norms to Reduce Clearance Time for Exports

The revenue department has relaxed norms for customs examination of export consignments at ports to reduce clearance time and transaction costs for exporters. The level of examination is determined by the amount of export incentive involved, value of exports and the type of export destination. The new rules are:

- For export goods packed and sealed before a customs/central excise officer at the factory or notified warehouses, there is to be no examination at ports except when the seal is found tampered with.
- For exports under free shipping bills where there is no export incentive involved, there is to be no examination.
- For exports under duty drawback or duty entitlement passbook (DEPB) schemes which involve exports incentives, the rules vary with the destination and the value of incentive. For example, if incentive is upto 1 lakh – then 25 per cent or 2 per cent of consignment is to be examined depending on the destination (sensitive or otherwise).
- For exports under the Export Promotion Capital Goods Schemes the level of examination depends upon the value of consignment and destination. For example, for consignments upto Rs 5 lakh value, 25 per cent or 2 per cent would be examined depending on the destination (sensitive or otherwise).

Sensitive destinations are Dubai, Sharjah, Singapore, Hong Kong and Colombo.

Source : The Economic Times

adequate testing facility, and maintaining prescribed norms of quality are permitted to certify their products for export. The exporter may apply to the Export Inspection Council for this purpose.

Recently, Export Inspection Agency has been encouraging Indian exporters to obtain ISO 9000 series quality certification, which is an internationally accepted quality certificate.

(viii) Customs clearance: The goods cannot cross the border of a country without the permission of the customs authority. Customs authority ensures the following :

(a) Lawful export or import;
(b) Authenticates the value of export or import;
(c) Assesses the duty;
(d) Compliance with the regulatory provisions; and
(e) Provides the export, import data for compilation.

Permission is granted by the customs authority on a document called Shipping Bill. The shipping bill is prepared by the exporter or her/his agent and submitted to the main customs house along with other required documents like invoice, license, inspection certificate, contracts, etc. These documents are carefully checked by the customs authority who may instruct physical examination of the goods at dock. After the port formalities, when goods are brought to the dock, the customs preventive officer at dock gives permission for shipment. She/he puts *Let Ship* order on the shipping bill. This permission is shown to the master of carrier, who allows the loading of the goods on the ship. When goods are received on the carrier, the captain issues *Mate Receipt* to the exporter. This document is a proof of shipment of the goods.

(ix) Port procedures: Exporters are expected to reserve the berth on the ship well in advance. The exporter or his agent brings the goods near the port. She/he contacts the port authorities and fulfils the formalities like obtaining permission, payment of port charges etc. for bringing the goods inside the shed. When permission is granted she/he brings the goods inside the shed. She/he presents the shipping bill to the shed appraiser. The shed appraiser examines the goods. If she/he finds the goods in order puts *Let Export* order on the shipping bill. The export cargo is loaded on ship under the supervision of customs preventive officer.

(x) Obtaining bill of lading: Exporter's agent presents the Mate's Receipt to the shipping company who issues the Bill of Lading to the agent.

(xi) Submission of documents to bank: After shipment of the goods, the exporters agent sends all relevant documents to the exporter. The exporter submits the required documents like bill of lading, bill of exchange, letter of credit, invoice, etc. to the bank for completing the formalities for payment.

10.6 Import Procedures

Following steps are involved in import procedures:

(i) Obtaining IEC Number and RCMC Number: The importer obtains Import Export Code Number and Registration-cum-Membership Certificate. The procedure involved has been explained earlier under Export Procedure.

(ii) Market research: The Importer undertakes market research and makes an inquiry for the required products. Based on response, the importer identifies the product to be imported and enters into the import contract.

(iii) Opening a letter of credit: Importer opens a letter of credit in favour of the seller in her/his bank. Letter of credit is an arrangement for payment. It is an arrangement whereby a bank acting at the request and in accordance with the instructions of the importer undertakes to make payment to or to the order of the exporter against stipulated documents and compliance with stipulated terms and conditions. The importer approaches her/his bank to open a letter of credit in favour of the exporter. She/he instructs the bank about the documents to be submitted by the exporter and terms and conditions of the contract. When the bank is satisfied, it issues the letter of credit. The issuing bank, which issues the letter of credit, undertakes to pay the exporter on the instructions of the importer.

The issuing bank may seek the help of other banks for advising, confirming, or negotiation. The banks which provide these services are known as advising bank, confirming bank and negotiating bank. Advising bank authenticates the credit. Confirming bank undertakes to pay the exporter in case of inability of issuing banker to make payment. The negotiating bank helps in negotiating the credit i.e., takes the documents and disburse the amount to the exporter. The advising, confirming and negotiating bank may also be the same bank. The exporter's bank delivers the documents relating to shipment to the issuing bank and receives payment. The payment is disbursed to the exporter.

(iv) Arrival of goods: Goods are shipped by the seller in accordance with the contract. When goods reach the importer's country, the person incharge of the carrier informs the proper officer at dock for unloading the cargo on a document called Import General Manifest. This document gives details of the imported goods.

(v) Informing importer: The importer is informed about the arrival of goods by the customs authority. The importer or his agent prepares Bill of Entry and submits it to the customs department along with relevant documents. Bill of Entry is a document on which customs officer gives permission for the clearance of the imported goods.

(vi) Customs clearance: Customs officer marks the bill of entry for assessment of customs import duty and appraisement to the concerned appraiser. The appraiser examines the

document carefully and gives the examination order. The importer or her/his agent procures the document from appraiser and makes payment of the customs duty.

The Bill of Entry is now presented to the dock superintendent. The dock superintendent marks the document to the examiner for physical examination of the goods. The examiner gives her/his report on the B/E. The importer's agent presents the B/E to the port manager. The port manager ensures the payment of charges and issues release order. On the basis of release order, goods are taken out of the customs area.

Import Duties to be Lowered to Twenty Per Cent

There is a proposal to lower peak import duty rates to 20 per cent. This will mean that the Indian industry will not be given protection in the form of higher import duties. The Indian industry will have to face the reality of globalisation and the increased competition.

To ensure greater openness of the Indian economy to trade and investment, a lowering of import duties is imperative. This would induce greater efficiency and improve quality of domestic production.

Lower protection is required to boost exports as well. Protection depresses exports. Higher domestic prices make it unattractive for manufacturers to leave the domestic market and sell abroad. The government then has to provide incentives in the form of subsidies (drawbacks) to encourage a producer in a highly protected economic environment to export her/his output.

There are many arguments in favour of lowering protection. However, Indian industry cannot become competitive just because import duties come down. They need efficient infrastructure, an efficient financial sector and flexible markets. The government must also meet these requirements while lowering the level of protection.

Import Duty on Cotton Doubled to Ten Per Cent

The government has hiked the basic customs duty on cotton to 10 per cent from 5 per cent to check a possible increase in imports. This was done to help cotton growers. Import data from the Commerce Ministry revealed a 34.86 per cent growth in imports of cotton and silk.

The cotton prices are ruling low in the international market. However, domestic prices are also low and well below the international level. But the hike in import duty would result in an increase in domestic prices of cotton and at the same time discourage imports. This would also remove farmers' fears of an import surge. The duty hike will further erode the competitiveness of Indian textiles in international market.

Source : The Economic Times

Industry Reaction to Proposal for Lowering of Import Duties to 20 Per Cent

Lowering import duties has an impact not only on external trade but on the entire industry. The industry does not seem to be prepared to face global competition. The industry puts forward many arguments as to why import duties should not be lowered.

(i) The cost of components in the Indian industry is much higher than these of global manufacturers.

(ii) The power costs in India are higher by 150-200 per cent compared to other countries.

(iii) The cost of capital is higher. Before lowering import duties there is a strong case for bringing about global parity in terms of financial costs.

(iv) Local taxes like sales tax, turnover tax, sales tax surcharge, octroi are much higher than other developing countries.

It is only through reforms in the power sector, the financial sector and the tax regime that Indian Industry can be brought on par with other countries on the globe.

Source : Business India

10.7 Export Import Documents

In export business, buyers and sellers are located in different countries. The business activities are carried out with the help of the documents. Documents protect the interests of the buyer and seller. The duty of the seller is to ship the goods as specified in the contract. Whereas, it is the duty of the buyer to make payment according to the contract. The documents are the basis of the contractual obligation between buyer and seller. In order to encourage foreign trade the government provides incentives. Documents are needed to claim these incentives. Export documents may be divided into two parts. They are: Principal Export Documents and Auxiliary Export Documents. Let us discuss them.

10.7.1 Principal Export Documents

These documents are needed for the purpose of transfer of goods from exporter to importer. They are also required for the realisation of payment. The principal export documents are as follows:

(i) Commercial invoice;
(ii) Packing list;
(iii) Bill of lading;
(iv) Certificate of inspection;
(v) Insurance certificate policy;
(vi) Certificate of origin;
(vii) Bill of exchange.

Let us discuss the principal export documents:

(i) Commercial invoice: This is a basic document for export business. It contains a detailed description of the goods supplied by the exporter. The name of buyers and sellers, name of

the ship, date of sailing, quantity and price of the product, marks and numbers of packages, etc. are described in the commercial invoice. It serves as an evidence of contract of sale and purchase. This document is required for obtaining clearance from various authorities like Export Inspection Agency, Central Excise Commissioner, Customs Authority, etc.

(ii) Packing list: It comprises the date of packing, connecting invoice number, order number, details of shipping, bill of lading number, date of sailing and details of goods etc.

(iii) Bill of lading: It is an important transport document issued by the shipping company or its agent. It acknowledges receipt of the goods by the shipping company, whereby the shipping company undertakes to make delivery of goods to the buyer or her/his agent in the same form as agreed upon.

The important features of bill of lading are:

(a) **A Receipt of goods**: This is a receipt given by the shipping company. It states the specifications and the conditions of the goods received by the shipping company.

(b) **A document of title to goods:** The bill of lading is a document which serves as a document of title to the goods. A bonafide holder of bill of lading can have the title to the goods. The title may be transferred by endorsement of the bill of lading.

(c) **A contract of affreightment:** The bill of lading is an evidence of the contract of affreightment. The contract of affreightment is a contract between the shipper (consignor) and the shipowner (shipping company) by which the shipowner undertakes to carry the goods of another (shipper) in consideration of a price called *freight*. This contains the terms and conditions of the carriage like payment, liability, loss, etc.

(iv) Airway bill: This is issued in case of air carriage. This document is issued by the airline company. The features of the airway bill are similar to those of the bill of lading except the title to the goods. Airway bill is not a document of title but it can be prepared in such a way that makes it a transferable document.

(v) Certificate of inspection: This certificate is issued by the Export Inspection Agency or the authorised person. It certifies that the consignment has been inspected as required under the Quality Control and Inspection Act.

(vi) Insurance policy: When goods transit from one country to another country, they are exposed to various risks of loss or damage. As a protection against these risks, the party is required to insure the goods and obtain insurance policy. This policy protects the risks of loss or damage in transit.

(vii) Certificate of origin: This document certifies the origin of the goods. It is issued by the Chamb

Commerce, Export Promotion Council or the Government Department.

(viii) Bill of exchange: This is a document relating to the payment for the goods supplied. According to the Negotiable Instruments Act, *a bill of exchange is an instrument containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to or to the order of a person or to the bearer of the instrument.* Thus, it is a document which instructs the drawee to make payment immediately or at a future agreed date. When immediate payment is required on the presentation, it is called *sight bill*. When it is accepted to make payment at a future date, it is called *usance bill*. Commercial Invoice, Bill of lading/Airway Bill, Insurance policy and Bill of exchange are the most important documents for a consignment under CIF contract, that is where the amount (price) payable includes cost, insurance premium and freight charges.

10.7.2 Auxiliary Export Documents

These documents are required for the preparation of the principal export documents. The auxiliary documents are as follows:

(i) Proforma invoice;
(ii) Intimation for inspection;
(iii) Shipping instructions;
(iv) Insurance declaration;
(v) Shipping order;
(vi) Mate's receipt;
(vii) Application for certificate of origin;
(viii) Letter to the bank for collection/negotiation of documents.

(i) Proforma invoice : It is an offer made by the exporter to the importer. This document contains the details of goods like quantity, price, etc. to be sold by the exporter.

(ii) Intimation for inspection: This document is given by the Export Inspection Agency. The exporter informs the agency on this document for the inspection of the export goods.

(iii) Shipping instructions: The *exporter provides various instructions* relating to export of goods to the shipping agent on this document.

(iv) Insurance declaration: The exporter who requires insurance, makes a declaration relating to the insurance policy on this document.

(v) Shipping order: This document is issued by the shipping company. It intimates the exporter about the reservation of space on board the ship.

(vi) Mate's receipt: Mate's receipt is issued by the chief officer of the ship. This receipt is an acknowledgement of the goods on the ship. It states the condition of the goods.

(vii) Application for certificate of origin: This application is submitted to the authorised Chamber of Commerce. It shows the origin of the goods from a particular country.

(viii) Letter to the bank for collection/negotiation of documents : This document contains details about shipping documents of the negotiation/collection. It is sent for banks by the exporter.

10.7.3 Import Documents

Bill of Entry is the main import document. The imported goods are cleared on this document. There are three types of bill of entry which are as follows:

(i) **Bill of entry for home consumption:** This document is presented when an importer wants to get his goods cleared in one lot on payment of customs duty. This is white in colour.

(ii) **Bill of entry for warehousing:** This document is presented when importer wants to shift goods to a warehouse. The importer does not pay the duty on the imported goods and goods are transferred to customs recognised bonded warehouses. This is yellow in colour.

(iii) **Ex-bond bill of entry:** This bill of entry is presented when importer wants to clear the goods from a bonded warehouse on payment of duty. This is green in colour.

Important Terms

These are some of the terms used in external trade:

Free on Board (FOB): Under FOB contract, exporters are expected to deliver the goods on the ships rail at the named port of shipment. The importer has to bear all costs and risks of loss or damage from this point.

Cost and Freight (CFR): Under CFR contract, exporters are expected to pay the costs and freight to bring the goods to the named port of destination. After this destination the importer bears the risk of loss or damage to the goods.

Cost Insurance and Freight (CIF): Under CIF contract, the exporter bears the costs and freight to bring the goods to the named port of destination and also procures marine insurance against the risks of loss or damage to the goods during the carriage. After this destination the importer bears the risk of loss or damage to the goods.

10.8 Export Promotion Measures

Export promotion measures have been initiated to improve the export performance of the country. Government of India has provided infrastructural facilities and provides marketing support and other facilities for this purpose. In order to promote export, the government announces EXIM Policy from time to time. Major export promotion measures are as follows:

(i) Export processing zones (EPZs): EPZs have been set up to provide an internationally competitive duty free environment for export production. Infrastructural facilities are created in the zones to manufacture the products at lower cost. Customs clearance and facilities needed for financial transactions are also provided inside the zones. Import licence is not needed for import of capital goods, raw materials, etc. The units located in the zones are exempted from payment of excise duty on capital goods and raw materials bought from

the domestic market. Fifty per cent produce has been permitted for domestic sale at concessional rate of duty. There are 8 EPZs in India.

(ii) Hundred per cent export oriented units: These units have been set up for the export of entire product except those which are specifically permitted to be sold in the domestic market. These units can be established any where in the country. They can avail of all benefits provided to the units in the EPZ.

(iii) Special economic zones (SEZ): It has been created to encourage free trade. It is a specifically delineated duty free enclave. It is deemed to be foreign territory for the purpose of trade operations and duties and tariffs. Goods going into the SEZ area from Domestic Tariff Area (DTA) are treated as deemed exports. Goods coming from the SEZ area into DTA are treated as imported goods.

(iv) Export Houses, Trading Houses, Star Trading Houses and Super Star Trading Houses: Various categories of export houses have been recognised with a view to building marketing infrastructure and expertise required for export promotion. These houses are given national recognition so that they could make greater efforts for export promotion. They are required to operate as highly professional and dynamic institutions and act as an important instrument of export growth. The recognition is granted on the basis of the export performance of the firm.

(v) Export of services: In order to boost the export of services, various

Exim Policy

The export-import policy 2002-07 will aim at reducing transaction costs through lowering tax rates, increased incentives or exports and improved infrastructure to facilitate the growth of exports. The focus of the policy will be on providing facilities to the state governments to support export-oriented activities. Suitable funds will also be provided to improve power scenario, services sector, labour laws and infrastructure to achieve the aim of 1 per cent share in total world trade.

Medium Term Export Strategy

The medium term export strategy stresses on the need to focus on key markets and select items, provide incentives compatible with WTO norms, undertake aggressive market promotion, speed up data collection, reduce transaction costs, liberalise FDI in flows and involve state governments in export promotion. A mix of fiscal incentives and positive export climate through free trade agreements with other countries is proposed. Instead of going by the earlier strategy of focusing on the supply side strengths, the government has moved on to a strategy based on demand in key markets.

Source : The Economic Times

categories of service houses have been recognised. These houses are recognised on the basis of the export performance of the service providers. They are named as Service Export House, International Service Export House, International Star Service Export House, International Super Star Service Export House based on their export performance.

(vi) Export Promotion Capital Goods (EPCG) Scheme: The main objective of this scheme is to encourage the import of capital goods for export production. New capital goods, including computer software systems may be imported under this scheme. Under this provision, the capital goods may be imported at 5 per cent customs duty. The import is subject to an export obligation equivalent to 5 times CIF value of capital goods on FOB basis or 4 times the CIF value of capital goods on net foreign exchange basis. This obligation may be fulfilled over a period of 8 years from the date of issuance of license.

(vii) Deemed exports: Deemed exports refer to those transactions in which the goods supplied do not leave the country. If goods are supplied to the specified categories of organisation like EPZ, EOU, projects funded by United Nations Agencies, etc. in India, they are treated as deemed exports. Deemed exports are eligible for the following benefits:

(i) Advance licence for intermediate supply/deemed export;

(ii) Deemed exports drawback;

(iii) Refund of terminal excise duty.

(viii) Duty exemption/remission schemes: These schemes are aimed at facilitating import for export production. The duty exemption scheme enables import of inputs required for export production. The duty remission scheme enables post replenishment/remission of duty on inputs used in the export product.

Under duty exemption scheme, an advance licence is issued for duty free import of inputs. The licence is subject to the actual user condition. Advance licence can be issued for physical exports, intermediate supplies and deemed exports.

Duty remission scheme consists of Duty Free Replenishment Certificate and Duty Entitlement Passbook Scheme. Both schemes allow drawback of import charges on inputs used in the export product.

(ix) Duty drawback: Exporters use imported indigenous raw materials and components for export products. They pay customs duty/excise duty on these materials. Under the scheme of duty drawback, customs and excise duties paid on raw materials and components used for export products are refunded back to the exporters.

(x) Export finance: Exporters require finance for the manufacture of the goods. Finance is also needed after the shipment of the goods because it may take sometime to receive payment from the importers. Therefore, two types of export finance are made available to the exporters by the authorised bank at concessional rate. They are termed as pre-shipment

Why Duty Drawback?

A producer of any finished product has often to buy from different outside sources her/his requirement of capital goods, raw materials, components intermediates, consumables, packing materials, etc. The items mentioned above may be imported or produced/manufactured within the country.

On imported goods, custom duties at appropriate rates have to be paid. As regards the indigenous input items required for production or manufacture, they have to suffer appropriate Central Excise Duty before clearance out of the factory of their production. The scheme of taxation in relation to Customs and Excise duties which has evolved has recognised the impact of multiple taxation on capital goods and on various inputs on the costs of production of goods. The central government, therefore, has evolved a scheme of duty drawback which essentially means grant of relief/refund of duties paid on inputs used in the manufacture of a product for export.

The object of the duty drawback system is to reimburse exporters for tariff paid on the imported materials and central excise duties paid on domestically produced input which enter into export production. Custom duties and excise duties on inputs raise the cost of production in export industries and thereby affect the competitiveness of exports. Therefore, escalation in their costs attributable to such customs and excise duties. Drawback rates are subject to change from time to time and announced by the central government.

Source : Custom and Central Excise Duties Drawback Rules.

Drawback Duty Hiked on 300 Items

The government has increased duty drawback on about 300 product groups under the Duty Entitlement Passbook Scheme (DEPB) in order to boost exports. This has been done as an exceptional measure to boost sagging exports in view of the prevailing world economic scenario and stiff competition.

Duty Drawback Rules Relaxed

The revenue department has relaxed through a recent circular, the rules of claiming duty drawback by merchant manufacturer exports of readymade woven garments.

The rules now allow duty drawback for central excise and customs duty to merchant manufacturer exporters on the basis of declarations that cenvat credit has not been availed by them or their job workers for inputs used in the items exported. Earlier a large number of drawback claims have been pending clearance due to the earlier demand for production of certification of non-avail met of cenvat credit in every case.

Source : The Economic Times

finance or packing credit and post-shipment finance. Under pre-shipment finance, finance is provided to an exporter for financing the purchase, processing, manufacturing or packing of goods for export purposes. Under the post-shipment finance, finance is provided to the exporter from the date of extending the credit after the shipment of goods to the date of realisation of export proceeds.

(xi) Market development assistance: Export marketing requires huge resources. It becomes very difficult for the exporter to market their products in the overseas market. They need assistance for this purpose. The main objective of the marketing development assistance is to stimulate exports from the country. Under this scheme, assistance is provided for marketing Indian products in the overseas markets. The marketing development assistance is provided for the following purposes:

(a) Individual sales-cum-study tours/trade delegations abroad;
(b) Individual participation in trade fairs/exhibitions and buyer-cum-seller meets abroad;
(c) Publicity and advertisement;
(d) Other specified activities.

(xii) Tax relief: Income tax exemption has been granted to promote exports. Under this scheme, export profits and foreign exchange earnings from other specified sources are exempted from income tax. The income tax exemption scheme is to be phased out over a 5 year period by 2004-2005. However, this scheme would remain operational for the units located in Export Processing Zones and 100 per cent Export Oriented Units. As far as sales tax is concerned, export sales are not subject to sales tax. Excise duty on export goods is also exempted or refunded to the exporters.

(xiii) Brand promotion and quality awareness: Quality is the most important element of export marketing. High quality branded products may be easily accepted in the overseas market. The government of India aims to encourage exporters attain internationally accepted standards of quality for their products. Government extends support to trade and industry to launch a nationwide programme on quality awareness and to promote the concept of total quality management. The central government also assists in the modernisation and upgradation of test houses and laboratories to bring them up to the international standards.

In order to promote Indian brands in the international market, India Brand Equity Fund (IBEF) trust has been established in 1996. The major objectives of this fund are to make the *Made in India* label a symbol of quality, competitive price, reliability and service to the customer and to project India as a reliable supplier of quality goods and services. IBEF has been supporting brand promotion of particular brands which have achieved world class quality and performance standards.

Exim Policy 2002-2007

The policy shows a commitment to realise the export potential in the country. The first step in this direction is the removal of quantitative restrictions on exports. Freedom to export will be given not only to the organised sector, but the agricultural, small and handicraft sectors also.

Towns of export excellence, that is industrial clusters like Tirupur and Ludhiana that are export oriented will be rewarded. Industry associations in such towns will have access to funds from Market Access Initiative (MAI) scheme. They will also enjoy facilities under the EPCG Scheme.

The Market Access Initiative has been allocated Rs 14.5 crores for the current year. The scheme aims at helping new exporters gain market access and promote their goods.

Special attention will be given to SEZs. It has been decided to convert four existing EPZs into SEZs. Overseas Banking Units (OBUs) would be permitted to be set up in SEZs. Indian banks would also be able to establish branches in SEZs. The OBUs would be exempt from the usual Cash Reserve Requirements (CRRs) and would be able to give SEZ producers access to international finances at international rates.

The initiative to reduce transaction costs and time which are major constraints to exports has also been shown.

Source : Business India

10.11 Export Processing Zones

These have been created to increase production base for export. These zones are industrial estates which form enclaves within the national customs territory. They are usually located near the international airport sea or port. The entire production of the units located in these zones is normally exported. The raw materials, intermediate product, equipment and machinery are allowed to be imported without payment of customs duty. There are seven export processing zones in India. They are as follow:

(i) Kandla Export Processing Zone (KEPZ), Kandla, Gujarat;

(ii) Santa Cruz Electronic Export Processing Zone (SEEPZ), Santa Cruz, Bombay;

(iii) Noida Export Processing Zone (NEPZ), Noida, UP;

(iv) Madras Export Processing Zone (MEPZ), Chennai, Tamil Nadu;

(v) Cochin Export Processing Zone (CEPZ), Cochin, Kerala;

(vi) Falta Export Processing Zone, (FEPZ) Falta, West Bengal;

(vii) Visakhapatnam Export Processing Zones (VEPZ), Visakhapatnam.

The government of India has converted Kandla Export Processing Zone, Santa Cruz Electronic Export Processing Zone and Cochin Export Processing Zone into Special Economic Zones.

The major objectives of these zones are:

(i) to earn foreign exchange;
(ii) to create employment;
(iii) to acquire and update labour and management skills;
(iv) to create links between EPZ industries and the domestic economy.

Export Processing Zones provide basic infrastructure like developed land, building, power, water, electricity, etc. to the entrepreneur. Customs clearance is provided in the zones without extra charge. Banks, post office, service, offices of clearing agents are also established in the zones.

10.12 Special Economic Zones

SEZ is a specifically delineated duty free enclave. SEZs are to be set up in different parts of the country with a view to providing an internationally competitive and hassle free environment for export production. SEZs will be permitted to be set up in the public, private, joint sector or by the state governments with a minimum size of not less than 100 hectares. These units may be for manufac-turing, trading or service activity. Package of incentives announced so far include exemption from industrial licensing for manufacture of items reserved for SSIs and removal of sectoral ceilings on Foreign Direct Investment (FDI) in SEZ units. It is deemed to be foreign territory for the purposes of trade operations and duties and tariffs. Goods going into the SEZ from domestic tariff area are treated as deemed exports. Goods coming from the SEZ area into domestic tariff area are treated as imported goods. The units in SEZ would be able to import capital goods and raw materials duty free. They would also be able to procure them from the Domestic Tariff Area without payment of excise duty. Permission would not be required for inter unit sales or transfer of goods. They would be able to undertake job

Proposal for a Liberal Package for Special Economic Zones (SEZs)

It is proposed to give Special Economic Zones (SEZs) flexibility to handle foreign exchange remittances especially, pre-payment of External Commercial Borrowings (ECBs). Relaxations from FEMA i.e., Foreign Exchange Management Act will be provided which will help SEZ units to operate their forex accounts without constraints. SEZs should be allowed to access External Commercial Borrowings Liberally and pre-pay it, without being bound by the norms applicable for Domestic Tariff Area (DTA) units. Since SEZ units would be re-paying ECBs out of their forex earnings, there should be no major imbalance in the country's forex reserves.

Source : The Economic Times

work for the DTA units and would be allowed to get their goods processed in the DTA. The movement of goods between SEZs and ports will be unrestricted and without any hindrances.

The SEZs imply a qualitative transformation of the traditional Export Processing Zones (EPZs). The improvements include 100 per cent FDI investment through automatic route to manufacturing SEZ units (barring a handful of sensitive industries) no routine examination by customs of export and import cargo in SEZs, all imports on self certification basis, duty free material to be utilised over five years,. no pre-determined value addition, DTA sales on full duty payment and various procedural simplification for operations like record keeping, inter-unit transfer, sub-contracting, disposal of obsolete materials etc.

Features

(i) A duty free enclave has been created which is treated as foreign territory for trade operations.
(ii) Units can be set up for manufacturing, trading and service activities.
(iii) Units are exempted from routine examination of import and export of cargo by customs.
(iv) Units should be a positive foreign exchange earner in three years.
(v) Sale in domestic market is permitted on payment of duty.
(vi) Duty free goods are allowed to be utilised within the approval period of 5 years.
(vii) Sub-contracting of production is allowed.
(viii) Hundred per cent foreign direct investment is permitted through automatic route in the manufacturing sector.

SUMMARY

Every country in the world is blessed with different kinds of natural resources. The country may possess mineral resources, water resources, labour and capital, technological capabilities, managerial abilities, etc. These factors facilitate the production of goods and services in a particular country. The country, which is endowed with these factors may produce some goods more efficiently than others. Thus, international trade facilitates efficient utilisation of factors of production.

Nature of external trade: This trade refers to buying and selling of goods and services between two or more countries. Since two countries are involved in external trade, the procedures, mode of payment, documentation, etc. differ from those of internal trade.

Importance of external trade: Competitive use of country's resources, Accelerates economic growth, Enhances competition Economies of scale, Increase

in employment, Brings efficiency, Stability in prices, Technological up gradation, Promotes global understanding.

Export procedures: The export procedure involves the following steps: Obtaining Importers Exporter Code (IEC) Number, Obtaining Registration-cum-Membership Certificate (RCMC), Market Research, Confirmation to Importer, Manufacturing Goods, Excise Clearance, Pre-Shipment Inspection and Quality Control,Customs Clearance, Port Procedures, Obtaining Bill of Lading, Submission of documents to Bank.

Import procedures: Following steps are involved in import procedures: Obtaining IEC Number and RCMC Number, Market Research, Opening a Letter of Credit, Arrival of Goods, Informing Importer, Customs Clearance.

Principal export documents: The principal export documents are as follows: Commercial Invoice, Packing List, Bill of Lading, Certificate of Inspection, Insurance Certificate Policy, Certificate of Origin, Bill of Exchange.

Auxiliary export documents: These are as follows: Proforma Invoice, Intimation for Inspection, Shipping Instructions, Insurance Declaration, Shipping Order, Mate's Receipt, Application for Certificate of Origin, Letter to the Bank for Collection/Negotiation of Documents.

Bill of entry: There are three types of bill of entry which are as follows: Bill of Entry for Home Consumption, Bill of Entry for Warehousing, Ex-Bond Bill of Entry.

Important terms: These are some of the terms used in external trade: Free on Board (FOB), Cost and Freight (CFR), Cost Insurance and Freight (CIF).

Export promotion measures: Export promotion measures have been initiated to improve the export performance of the country. Major export promotion measures are as follows: Export Processing Zones, 100 per cent Export Oriented Units, Special Economic Zones, Export Houses, Trading Houses, Star Trading Houses and Super Star Trading Houses, Export of Services, Export Promotion Capital Goods (EPCG) Scheme, Deemed Exports, Duty Exemption/Remission Schemes, Export Finance, Market Development Assistance, Tax Relief, Brand Promotion and Quality Awareness.

Export processing zones: These Zones have been created to increase production base for export. These zones are industrial estates which form enclaves within the national customs territory. The major objectives of these zones are: to earn foreign exchange, to create employment, to acquire and update labour and management skills, to create links between EPZ industries and the domestic economy.

Special economic zones: This is a specifically delineated duty free enclave. SEZs are to be set up in different parts of the country with a view to provide an internationally competitive and hassle free environment for export production. SEZs will be permitted to be set up in the public, private, joint sector or by the

state governments with a minimum size of [illegible] than 100 hectares. The SEZs imply a qualitative transformation of the traditional Export Processing Zones (EPZs).

EXERCISES

Short Answer Type Questions

1. How does external trade help in stabilising the prices of a product ?
2. How do you open a letter of credit ?
3. What are the features of bill of lading ?
4. What is bill of exchange ?
5. What is bill of entry ?
6. What do you mean by export processing zones ?
7. What is deemed export ?
8. What is duty drawback ?

Long Answer Type Questions

1. Describe the nature and importance of external trade.
2. You want to export books to Paris. Explain the procedures of export for exporting the books to Paris.
3. You are planning to import pens from New York. Explain the procedures of import of pens from New York.
4. Explain the features of principal export documents.
5. Explain various export promotion measures provided by government of India in brief.
6. How do special economic zones provide a different environment for export production?

Project Work

1. Study the working of a small export unit. Find out whether they actually follow the procedure outlined. How much support do they get from the government in the form of incentives and drawbacks?
2. Collect information on Special Economic Zones (SEZs) from newspapers and business magazines. Interview some exporters and find out their opinion on Export Processing Zones and Special Economic Zones.